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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 75-16

HAYES INTERNATIONAL CORPORATION, *Petitioner*

v.

DR. JOHN L. McLUCAS,
SECRETARY OF THE AIR FORCE, *Respondent*

and

THE BOEING COMPANY, *Intervenor-Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Petitioner, Hayes International Corporation, respectfully prays that a Writ of Certiorari issue to review the opinion and judgment of the United States Court of Appeals for the Fifth Circuit in this proceeding.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit is reported at 509 F.2d 247 (5th Cir. 1975), and appears in Appendix A, *infra,* pages 1a-30a. The un-

reported opinion of the United States District Court for the Northern District of Alabama, Southern Division, appears in Appendix B, *infra,* pages 31a-40a.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on March 6, 1975. On May 24, 1975, Mr. Justice Powell extended the time within which to file a petition for a writ of certiorari to and including July 3, 1975. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) (1970).

QUESTIONS PRESENTED

This case raises issues of national importance with respect to protecting the public interest as required by public policy in the operation and integrity of the federal procurement system. The ultimate legal issue before the Court involves a question of conflict of interest in the award and performance of a Government contract. The potential costs to the American taxpayer resulting from the conflict of interest exceed $200,000,000., which will be harvested by a contractor whose opportunity for biased judgment to enhance its own rewards is encouraged by respondent, Secretary of the Air Force.

The central issue in this case is as follows:

1. Whether the award by respondent of Government contract No. F34601-71-C-3366 to the Boeing Company for maintenance and modification services on the world-wide Air Force KC-135 fleet resulted in an *inherent and illegal conflict of interest;* and whether therefore, contrary to the decision of the Court of Appeals, respondent's action was arbitrary and capri-

cious, without a rational basis, contrary to public policy and to the public interest in maintaining the integrity of the federal procurement system, and contrary to the applicable law.

This case also raises the following subsidiary issues which are related to the ultimate issue set forth above.

2. Whether a *conflict of interest* results from Boeing's performance concurrently of sustaining engineering services under contracts [1] for the Air Force on the KC-135 fleet and its performance of maintenance and modification services on the fleet under contract No. F34601-71-C-3366;

3. Whether Boeing's judgments and engineering decisions under its sustaining engineering contracts for the KC-135 fleet will either be *biased* or provide the *opportunity for bias* in favor of maintenance requirements and modifications which Boeing will concurrently perform and of which Boeing will receive the economic benefit under the maintenance and modification contract (No. F34601-71-C-3366); and

4. Whether the competition for contract No. F34601-71-C-3366 was unfair because of information and opportunities provided only to Boeing by its privileged relationship with the Air Force and its con-

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[1] The Court of Appeals described Boeing's performance under the "sustaining engineering and related support services contracts" as follows:

> "Pursuant to these contracts Boeing had made specific recommendations as to what maintenance and modifications were required on the entire fleet of more than 700 KC-135 aircraft. Boeing continues to operate under these sustaining engineering and related support services contracts. These were awarded to Boeing on a 'sole source' basis without competition or open bidding, . . ." (App. A, p. 6a)

tracts for sustaining engineering services on the KC-135 fleet, and whether Boeing had an *unfair competitive advantage* over the other offerors, including petitioner.

The Court of Appeals never reached the issue of conflict of interest. The court avoided this issue by deciding, erroneously, that the statutes and regulations which prohibit conflicts of interest in federal procurement were *inapplicable* to this case. It further held that there was no public policy which could be enforced judicially to void Government contracts "tainted by such a conflict of interest."[2] (App. A, p. 30a fn. 26) The court relied upon the "administrative interpretation" of the regulations by the respondent, Secretary of the Air Force, to the effect that they were not "meant" to apply to the types of contracts involved in this case.

The decision of the Court of Appeals thus also raised the following issue for review by this Court.

5. Whether the Armed Services Procurement Act of 1947, 62 Stat. 21 (1948), 10 U.S.C. § 2304 *et seq.* (1970), as implemented by specific regulations of the Department of Defense which prohibit conflicts of

[2] The Court of Appeals stated:

> The plaintiff proposes an alternative basis on which it seeks to have contract 3366 voided. *Relying on what it identifies as the rationale of United States* v. *Mississippi Valley Generating Co., 364 U.S. 520, 81 S.Ct. 294, 5 L.Ed.2d 268 (1961), the plaintiff proposes that a general public policy against conflicts of interest is sufficiently strong to justify voiding a contract which arguably is tainted by such a conflict of interest.* We feel we must decline the invitation to develop such a novel "Federal common-law of Government procurement," premised upon what a court can be persuaded is desirable procurement policy. [App. A, p. 30a fn. 26; Emphasis added.]

interest in federal procurement, *viz.*, § 1-113.2 and Appendix G of the Armed Services Procurement Regulation (ASPR), 32 CFR § 1.113-2 and Part 141 (1971), is applicable to the Government contracts involved in this case.

STATUTES AND REGULATIONS

The pertinent statutes and regulations are the Armed Services Procurement Act of 1947, 62 Stat. 21 (1948), 10 U.S.C. § 2304 *et seq.* (1970), as implemented by § 1-113.2 and Appendix G of the Armed Services Procurement Regulation (ASPR), 32 CFR § 1.113-2 and Part 141 (1971). The regulations appear in Appendix C to this petition, *infra* at pages 41a-52a.

STATEMENT OF THE CASE

On September 13, 1971, Hayes International Corporation ("Hayes"), petitioner herein, brought this action in the United States District Court for the Northern District of Alabama, Southern Division, for declaratory and injunctive relief to set aside as illegal and void a Government contract awarded by the respondent, Secretary of the Air Force, to the Boeing Company ("Boeing"). The contract, designated No. F34601-71-C-3366, is for certain maintenance, modification and related services on the worldwide Air Force fleet of KC-135 aerial tankers. Contracts of this type are referred to in the industry as "IRAN/Modification" contracts.

The essence of petitioner's case is that respondent's action of awarding the subject IRAN/Modification contract to Boeing (through his subordinate chain of command in the Department of Defense) resulted in an *inherent and illegal conflict of interest.* The con-

flict of interest exists because Boeing is required to perform under the IRAN/Modification contract that same work which Boeing recommends, influences and determines for the Air Force under sustaining engineering and related support services contracts on the KC-135 fleet, acting as the "engineering arm" of the Air Force for the fleet. Simply stated, respondent has placed Boeing in a position to "write its own ticket" and serve its own monetary interest under the IRAN/Modification contract, at the expense of the integrity of the federal procurement system and at a potential cost to the American taxpayer of more than $200,000,000.

On September 30, 1971, the district court issued a preliminary injunction enjoining respondent from taking any action pursuant to the contract awarded to Boeing. On October 14, 1971, the Court of Appeals for the Fifth Circuit granted respondent's motion for a stay of the injunction pending appeal. Thereafter, petitioner moved the district court to vacate the preliminary injunction. Petitioner stated that it was in the " 'best interest of all the parties that this case proceed as quickly as possible to a judgment on the merits' inasmuch as the challenged contract was then scheduled to extend for as long as five years." (App. A, p. 4a) Petitioner's motion was granted.

The case was tried before the district court without a jury. The court held that it had jurisdiction of the case and that petitioner had standing to sue. On the merits, it held that Boeing did not enjoy an unfair competitive advantage in the bidding and was not party to a conflict of interest which might bias its judgment in performance of the contract.

On appeal to the Court of Appeals for the Fifth Circuit, the court affirmed the decision of the district court

on jurisdiction, but decided the case on the merits on different grounds. The court held that an unsuccessful bidder such as petitioner has standing under Section 10 of the Administrative Procedure Act, 5 U.S.C. § 702 (1970), to challenge the award of a Government contract. However, the court never reached the central issue of conflict of interest. Rather, it accepted respondent's "administrative interpretation" that the federal regulations prohibiting organizational conflicts of interest were not "meant" to apply to the types of contracts involved in this case. (App. A, p. 24a) While acknowledging that these contracts arguably are "tainted" by a conflict of interest, the court held that there was no "general public policy" against conflicts of interest sufficiently strong to justify judicial intervention and voiding of the contracts.

REASONS FOR GRANTING THE WRIT

This case raises compelling issues of substantial importance to the operation and integrity of the federal procurement system. It presents to this Court *for the first time* major questions involving "organizational" (as opposed to "individual") conflicts of interest in federal procurement as it affects public policy and the public interest.

An organizational conflict of interest occurs when an "organization" (*i.e.*, a corporation, partnership, or proprietorship) holding a Government contract is, by virtue of work or services performed for the Government under that contract, or by virtue of privileged information acquired from the Government in the course of performance:

(1) Placed in a position where its judgment may be *biased;* or

(2) Given an *unfair competitive advantage* over other organizations with respect to future Government business; or

(3) Otherwise placed in a position where a *conflict of interest* exists between the performance of work or services for the Government in an impartial manner and the organization's own self-interest.

Although this is a *civil* case, it nonetheless follows in spirit and form the mandate of this Court in *United States* v. *Mississippi Valley Generating Co.*, 364 U.S. 520 (1961), and *United States* v. *Acme Process Equipment Co.*, 385 U.S. 138 (1966). In those cases, the Court considered the public policy reflected in the federal conflicts of interest statutes. The Court stated in *Mississippi Valley* that the "primary purpose" of such statutes is to "guarantee the integrity of the federal contracting process and to protect the public." (364 U.S. at 565) The relief which petitioner seeks in this Court, and which the courts below denied, is "dictated by the public policy manifested" in the applicable procurement statutes and regulations. *Id.*

The decision of the Court of Appeals leaves open the question of whether there presently exists *any* viable remedy against a conflict of interest in the award and performance of a Government contract. According to the court below, only a narrow remedy exists for those cases within that court's and respondent's restricted reading of the federal regulations. The *public policy* against conflicts of interest—which traces its genesis to the common law—was thus said to be of no effect.

It is critical for this Court to reverse the decision below to make clear that the existing federal regulations, correctly interpreted, do protect the public

against conflicts of interest, and that in any event, the public policy against conflicts of interest and illegal contracts still applies.

The Court of Appeals decision also dramatically altered long accepted standards for statutory interpretation. By accepting as authoritative the administrative "interpretation" of the pertinent regulations, proffered in the course of litigation and after the controversy herein arose, the court ignored the plain language of the regulations and their legislative intent—even though acknowledging that a conflict of interest arguably existed. If the decision below is permitted to stand unreversed, Government personnel will hereafter be on notice that by way of "interpretation," they can effectively avoid compliance with regulations in the public interest governing their activities.

I. The Contract Awarded by Respondent to Boeing is Illegal and Void: The Court of Appeals Erred in Not Deciding on its Merits the Issue of Conflict of Interest.

Conflict of interest is central to this case. Petitioner contends that the IRAN/Modification contract awarded by respondent to Boeing is illegal and void as against public policy and the applicable federal regulations, and should have been set aside by the court below.

An "organizational" conflict of interest arises in this case because the maintenance and modification work on the KC-135 fleet performed by Boeing (an "organization") for the Air Force under contract No. F34601-71-C-3366 is and will be largely determined and influenced by *Boeing* pursuant to its recommendations to the Air Force under its concurrent and ongoing sustaining engineering contracts for the KC-135 fleet.

It is just this kind of conflict of interest which historically has been prohibited as against public policy and which the federal regulations against conflicts of interest were intended to prevent.

On June 23, 1971, respondent awarded the subject IRAN/Modification contract to Boeing, effective July 2, 1971. The contract price on the date of award was $12,294,894.16 for the first of five years of similar work requirements. The approximate total five-year cost to the Government was $60,000,000. At the time of the award of the contract, a "White House source" was quoted in *The Wichita Eagle and The Beacon,* a Wichita, Kansas newspaper,[3] dated July 3, 1971, to the effect that the contract could be worth nearly $200 million during the next five years." (Plf's Exh. 3-A)

Because of the obvious inconsistency between the Boeing bid and the White House report of the potential value of the contract to Boeing, petitioner's suspicions were understandably aroused and petitioner initiated an immediate inquiry concerning the overall relationship between Boeing and the Department of Defense (Air Force) with respect to the KC-135 fleet. At the same time, petitioner retained counsel to assist in this inquiry by obtaining documents pursuant to the Freedom of Information Act.

The contracts and other documentation which petitioner obtained in its inquiry revealed an extraordinarily close and privileged relationship between Boeing and the Air Force. Petitioner discovered that for many years prior to the bidding, Boeing and the Air Force were parties to a series of ongoing contracts

[3] Boeing planned to perform the contract at its Wichita, Kansas, facility.

whereby Boeing furnished the Air Force with sustaining engineering and related support services on the worldwide Air Force KC-135 fleet.

There was no real dispute below as to the nature of the services which Boeing performs for the Air Force under its sustaining engineering and support services contracts on the KC-135 fleet. The Court of Appeals described the Boeing-Air Force relationship as follows:

> For a number of years before contract 3366 was awarded Boeing had been under contract to the Air Force to supply sustaining engineering and related services for the KC-135 fleet. . . . The trial court found that *Boeing's relationship under the sustaining engineering and related support services contracts was essentially as the "engineering arm" of the Air Force for the KC-135 fleet.*
>
> Among its findings of fact, the trial court found: (1) as the contractor responsible for sustaining engineering for the KC-135 fleet, Boeing proposed a number of different modifications and improvements in the KC-135 design; (2) Boeing as part of its duties under the sustaining engineering contracts conducted a series of tests, evaluating fatigue stress, and other factors which affect the durability and usefulness of each aircraft; and (3) *Boeing was thus privy to technical data it generated as well as that provided by the Air Force.* It was undisputed that Boeing was responsible for recommending to the Air Force what priority should be placed on any particular set of repairs.
>
> The repairs and modifications which Boeing recommended to the Air Force comprised in part the work the IRAN/Modification contractor would perform. *Boeing was thus in a position to recommend changes and modifications to aircraft which*

would enhance the value of the IRAN/Modification contract it subsequently was awarded. [App. A, pp. 6a-8a; Emphasis added.]

The Court of Appeals thus found that the opportunity for Boeing to exercise biased judgment for its own monetary interest did in fact exist. It is this precise condition which creates an organizational conflict of interest. The only real dispute becomes a question of whether this conflict of interest is illegal.

Since, as found by the court below, "Boeing was thus in a position to recommend changes and modifications to aircraft which would enhance the value of the IRAN/Modification contract," can a conflict of interest be doubted? Can one reasonably conclude that Boeing did not benefit from *and use* for its monetary gain the "vital information" which the court below found that the Air Force provided to Boeing and which Boeing's competitors did not possess? Can one reasonably separate Boeing's role as advisor to the Air Force concerning modifications to the fleet from its dual and conflicting role as "competitive" bidder to perform the modifications? We think not. Boeing held an unfair competitive advantage and utilized it.

The nub of the matter is that a conflict of interest exists because Boeing has gained a substantial *economic stake* in recommending to the Air Force under its sustaining engineering contracts specific modifications which Boeing will accomplish under the IRAN/Modification contract. This is a classic case of "the left hand feeding the right" and of a conflict of interest.

The evidence before the court below went far beyond a mere description of the conflict of interest *potential* in the Boeing/Air Force privileged and dual relationship. Petitioner obtained documents on discovery which evidenced *actual changes* which were made to the subject contract after its award in June, 1971 by respondent to Boeing. *These changes involve expenditures in the $200,000,000 range referenced by the unnamed "White House source" at the time of award.*

The Court of Appeals stated:

> At trial *Hayes proved that Boeing recommended three specific sets of modifications which had the effect of greatly increasing the value of the IRAN/Modification contract it obtained, information which neither of its competitors possessed at the time of bidding.* These three sets of repairs involved alterations to the aerial boom,[7] and two sets of wing modifications. One of the wing modifications is actually being performed by Boeing under its IRAN/Modification contract, as is the aerial boom modification but the most substantial repair, Wing Fatigue Package V (which was valued as being in excess of $200,000,000) was awarded to Boeing subsequent to the filing of this litigation on a sole source basis.[8]

[7] The aerial boom is the nozzle by which fuel is transferred in mid-air from the KC-135 tanker to other aircraft. The alterations in it which Boeing performs under its IRAN/Modification contract have an estimated cost of $2,000,000.

[8] The two sets of wing modifications were issued in the form of so-called "Wing Fatigue packages," both of which Boeing performed. Wing Fatigue Package IV was issued to Boeing under the IRAN/Modification contract 3366. *Wing Fatigue Package V involved far more extensive changes in the wings of every KC-135 aircraft, and at a unit price of $313,934.00 amounts to a total cost for a modification of the entire fleet of over $200,000,000.* This modification was later issued to Boeing under a separate contract, No. F34601-72-C-4213-PZ0003, as opposed to being assigned to Boeing under its IRAN/Modification contract.[4] [App. A, pp. 9a-10a; Emphasis added.]

[4] The Court of Appeals correctly noted that the Wing Fatigue Package V modification was known by the contracting officer to be

It is difficult to conceive of a case where the facts more demonstrably evidence a conflict of interest, or where judicial intervention is more appropriate. Even assuming (as we do *not*) that the federal regulations prohibiting conflicts of interest were inapplicable to the "types of contracts" involved herein, no reasonable basis exists for the Court of Appeals' refusal to recognize and enforce the established public policy against illegal contracts.

It is fundamental under common and statutory law that a contract against public policy is void and illegal. 6A Corbin § 1375 (1962 ed.) Clearly, there is a public policy against a Government contract which embodies or creates a conflict of interest.

Petitioner does not seek to develop what the Court of Appeals referred to as a "novel" federal common law of Government procurement. (App. A, p. 30a fn 26) That "federal common law" is *not* novel but has been recognized specifically by this Court and most of the lower federal courts. *See Priebe & Sons, Inc.* v. *United States,* 332 U.S. 407, 411 (1947); *United States* v. *Wegematic Corp.,* 360 F.2d 674, 676 (2d Cir. 1966); *Northern Helex Co.* v. *United States,* 197 Ct. Cl. 118, 130, 455 F.2d 546, 553 (1972). It is an essential and established ingredient to the overall operation of the federal procurement system. All petitioner seeks in this case is to obtain *enforcement* of

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worth in excess of $200,000,000. He awarded a separate contract to Boeing for that modification and thereby avoided substantially increasing the price of the IRAN/Modification contract which was still in litigation before the court. This was for the administrative convenience of the Government. Fatigue Package V could have been accomplished by issuance of a change under the IRAN/Modification contract.

the law to prevent performance by Boeing under the patently illegal contract awarded to it by respondent. Judicial intervention to this end is critical to maintain the honesty and integrity of the federal procurement system.

II. The Court of Appeals Erred in Accepting Respondent's Interpretation That the Federal Organizational Conflict of Interest Regulations Are Inapplicable to This Case.

According to the Court of Appeals,

> the issue in this case comes down to the relatively straightforward one of the extent to which the Department of Defense rules on avoidance of organizational conflicts of interest were meant to apply to the type of engineering contracts which Boeing held for the KC-135. [App. A, p. 24a]

We have indicated that regardless of the applicability of the federal regulations, the IRAN/Modification contract awarded by respondent to Boeing is void and illegal as against public policy. In any event, however, the Court of Appeals clearly erred in accepting respondent's self-serving "interpretation" that the regulations were not "meant" to apply to the type of contracts involved in this case.

The Armed Services Procurement Act of 1947, as amended, is the basic organic statute which authorizes the Department of Defense to issue regulations governing federal procurement. These regulations are known collectively as the Armed Services Procurement Regulation (ASPR) and are codified in Title 32 of the Code of Federal Regulations. The provisions of the Armed Services Procurement Regulation have the full force and effect of statutory law. *Paul* v. *United States,* 371 U.S. 245 (1963). *See G. L. Chris-*

tian and Associates v. *United States,* 160 Ct. Cl. 1, 312 F.2d 418, *rehearing denied,* 160 Ct. Cl. 58, 320 F.2d 345, *cert. denied,* 375 U.S. 954 (1963).

Section 1-113.2 of ASPR (32 CFR § 1.113-2 (1971)) concerns organizational conflicts of interest. It mandatorily requires that "action must be taken" by the agencies and subentities of the Department of Defense to prevent such conflicts of interest from arising under defense contracts. Appendix G of ASPR (32 CFR Part 141 (1971)) sets forth the Rules for the Avoidance of Organizational Conflicts of Interest. These ASPR provisions codify the established common law public policy against illegal contracts.

The Court of Appeals completely misread and misinterpreted the conflict of interest regulations. Contrary to the court's decision, nothing at all in ASPR § 1-113.2 or Appendix G even remotely suggests that the regulations or the Rules for the Avoidance of Organizational Conflicts of Interest apply or were intended to apply only to research and development contracts, as alleged by respondent;[5] or that sustaining engineering and support services contracts, or IRAN/Modification contracts, are excepted from compliance therewith; or that they apply only to contractors who perform "systems engineering" and "technical direction."[6] The Court of Appeals accepted

[5] Even if that were true, respondent's own internal regulations indicate that the Air Force Logistics Command, which issued the subject contract, does, in fact, engage in research and development in the maintenance and modification of aircraft. (Def.'s Exh. 12)

[6] To the contrary, ASPR also makes its organizational conflict of interest regulations applicable to contracts for architect-engineer services and mandatorily prohibits the awarding of a construction contract to the architect-engineer. (ASPR § 18-115, 32 CFR § 18.115 (1974)) Clearly, architect-engineer contracts are unrelated to the concept of "systems engineering/technical direction" and are *not* for research and development.

The only reference to systems engineering and technical direction in the ASPR provisions governing organizational conflicts of interest appears in Rule 1 of Appendix G. The Rules are only examples of possible conflict of interest situations and thus the facts of this case need not be artificially fashioned to comply therewith. Nevertheless, this case does come within Rule 1. The "system" to which Rule 1 applies herein is the weapons system consisting of the KC-135 fleet of aircraft. Pursuant to its sustaining engineering and other related support services contracts on the KC-135 fleet, Boeing performs systems engineering and technical direction on this "system" within the contemplation of Rule 1 and thus comes within the prohibitions of that Rule.

respondent's narrow and self-serving reading of the regulations, without recognizing that in doing so it rendered them a nullity at the Government's discretion.

Appendix G states that: "[Conflict of interest] arises in several forms—not all of which are by any means yet fully understood." The Appendix was made part of the Armed Services Procurement Regulation in 1962. This case contributes substantially to a better understanding of the "forms" and circumstances which give rise to organizational conflicts of interest.[7] The Rules for the Avoidance of Organizational Conflicts of Interest set forth in Appendix G warn:

[7] The National Aeronautics and Space Administration (NASA), like the Department of Defense, derives its procurement authority in part from the Armed Services Procurement Act of 1947. For a number of years, the NASA Procurement Regulations incorporated the same Appendix G language as did ASPR. In 1971, NASA replaced Appendix G with a simplified regulation. That regulation states that it has been NASA's experience that organizational conflicts of interest "most frequently" have their origin in support services contracts. (41 CFR § 18-1.113-2(b)(1974)) It makes no distinction as to the type of services involved.

> The following rules state general prohibitions which are then explained and illustrated by specific examples. *There will undoubtedly occur cases which are not resolved by these rules.* . . . The following rules and examples are not all inclusive but merely attempt to achieve these two goals in a variety of situations. [Emphasis added.]

The "two goals" referred to in the quoted paragraph above, which the Rules state "should be paramount" in determining the existence of a conflict of interest, are: 1) "preventing conflicting roles which might bias a contractor's judgment"; and 2) "preventing unfair competitive advantage." The Rules state that, "the ultimate test should always be: Is the contractor placed in a position where his judgment may be biased, or where he has an unfair competitive advantage? If so, corrective action must be taken. . . ."

The federal regulations dictate that contracting "organizations" should not be "permitted to develop a privileged relationship to the Department of Defense." (ASPR Appendix G) A contractor such as Boeing which functions—under non-competitive sole source contracts—as the "engineering arm" of the Air Force for a major weapons system, and has access to "vital" Government information unavailable to its competitors, has such a "privileged" relationship with that Department and thereby gains an unfair competitive advantage.

The Court of Appeals erroneously described the Boeing sustaining engineering contracts as requiring mere "fix-it" engineering, compared with the allegedly more "sophisticated" contracts to which the regulations were "meant" to apply. This is completely in-

consistent with the Government's own rationale for employing Boeing as a sustaining engineering contractor for the KC-135 fleet, namely, that the Air Force does not have the techincal expertise to perform the sustaining engineering functions and, accordingly, has no choice but to rely on what Boeing recommends.

Significantly, the Supreme Court has considered the question of conflict of interest arising in federal procurement, albeit in different circumstances. In *United States* v. *Mississippi Valley Generating Co., supra,* this Court rejected arguments which would have restrictively limited application of the federal employees' conflict of interest statute, 18 U.S.C. § 434 (1970). This is exactly what the Court of Appeals did in this case by restrictively limiting application of the federal procurement organizational conflict of interest regulations. In *Mississippi Valley,* this Court stated:

> The moral principle upon which the statute is based has its foundation in the Biblical admonition that no man may serve two masters, Matt. 6:24, *a maxim which is especially pertinent if one of the masters happens to be economic self-interest.* [364 U.S. at 349-51; Emphasis added.]

The Court of Appeals recognized the nature of the conflict of interest opportunity and potential which Boeing's privileged relationship with the Air Force afforded. The reasonable and necessary *result* of that relationship is the conflict of interest and unfairly competitive bid. The mere *existence* of that relationship is inimical to the public interest. Along these same lines, this Court stated in *Mississippi Valley,* as follows:

> This broad proscription embodies a recognition of the fact that *an impairment of impartial judgment can occur in even the most well-meaning men when their personal economic interests are affected by the business they transact on behalf of the Government.* To this extent, therefore, the statute is more concerned with what might have happened in a given situation than with what actually happened. [364 U.S. at 549-50; Emphasis added.]

Insofar as serving the public interest, there is no difference between personal economic interests as they affect an individual (*Mississippi Valley*) and economic interests as they affect Government contractors such as Boeing. The end result is the same.

Finally, in *Mississippi Valley* this Court held that the invalidation and non-enforcement of the tainted contract was essential to effectuate the public policy which the conflict of interest statute reflected, notwithstanding that the statute did not specifically provide for invalidation and non-enforcement. (364 U.S. at 564-65) For the same reason, it is essential that the illegal contract awarded by respondent to Boeing be voided to preserve the integrity of the procurement system and to implement the strong public policy against conflicts of interest.

CONCLUSION

In summary, the Court of Appeals for the Fifth Circuit erred in not reaching directly the conflict of interest issue in this case, and in deciding that the respondent properly interpreted as inapplicable to the Government in this case the federal regulations which prohibit organizational conflicts of interest.

For the foregoing reasons, a Writ of Certiorari should be issued to review the decision of the Court of Appeals.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS,
FIFTH CIRCUIT.

No. 73-2765.

HAYES INTERNATIONAL CORPORATION, *Plaintiff-Appellant,*

v.

DR. JOHN L. McLUCAS, Secretary of the Air Force,
Defendant-Appellee.

THE BOEING COMPANY, *Intervenor-Appellee.*

March 6, 1975.

Appeal from the United States District Court for the Northern District of Alabama.

Before TUTTLE, COLEMAN and AINSWORTH, Circuit Judges.

TUTTLE, Circuit Judge:

This case involves a suit by an unsuccessful bidder for a Government contract to have the contract awarded to a competitor set aside as being in violation of the regulations of the Department of Defense governing conflicts of interest in Federal procurement, § 1-113.2 and Appendix G of the Armed Services Procurement Regulations (ASPR), 32 C.F.R. § 1-113.2 and Part 141 (1971).[1] The

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[1] 32 C.F.R. § 1-113.2 (1971) Organizational Conflicts of Interest provides that:

> "(a) Appendix G—Rules for the Avoidance of Organizational Conflicts of Interest sets out some of the more essential policy considerations of the Department of Defense with respect to relationships with nonfederal institutions. Specifically, Appendix G describes examples of various organizational conflicts of interest which might come into being, and rules for avoidance of such conflicts: and it provides that action must be taken to avoid placing a contractor in a position where his judgment might be biased or where he would have an unfair competitive advantage within the scope and intent of the rules.

successful bidder, the Boeing Company, joined the suit as defendant-intervenor.

However, the Appendix cannot of itself impose any obligations on the contractor: such obligations must be imposed by a contract clause designed to carry out the intent of the Appendix. Furthermore, potential contractors must be advised in the solicitation as to the extent of applicability of the rules, and must be given an opportunity to negotiate on the terms of the clause and its application.

(b)(1) The contracting officer is responsible for applying the rules in the Appendix to contracts under his cognizance and shall determine whether such proposed procurement is subject to the Appendix. . . ."

The general provisions of 32 C.F.R. § 1-113.2 further provide for procedures by which the contracting officer may determine whether a potential conflict of interest exists, and the method by which he is to deal with that potential conflict. It concludes:

> "(c) The contracting officer shall not impose restrictions under the Appendix in follow-on procurements on any prospective contractor in the absence of a specific contractual agreement with that contractor."

Appendix G of the Armed Services Procurement Regulations states four rules for the avoidance of organizational conflicts of interest. In the Preamble to those rules the regulation states "[w]here the Department of Defense does contract for research and development work, as it must for the bulk of that work, its choice of a contractor should be based primarily upon two considerations:

'(1) Getting the job done effectively and efficiently, with due regard to the long-term strength of the Nation's scientific and technical resources, and

(2) Avoiding assignments of work which would create inherent conflicts of interest.' "

Appendix G then sets out four specific rules on possible organizational conflicts of interest which state general prohibitions which are explained and illustrated by specific examples. The rules are said not to be meant to be viewed as all-inclusive.

> "There will undoubtedly occur cases which are not resolved by these rules. As the Bell Report [Bureau of the Budget, Report to the President on Government Contracting for Research and Development, Sen.Doc.No. 94, 87 Cong., Second Sess. (1962)] said '[Conflict of Interest] arises in several

The district court originally issued a preliminary injunction enjoining the Secretary of the Air Force from

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forms—not all of which are by any means yet fully understood.' In order to assist in deciding what, if any, prohibition should be applied in such instances, the two basic principles of this Code—(1) preventing conflicting roles which might bias a contractor's judgment, and (2) preventing unfair competitive advantage—should be paramount. The following rules and examples are not all-inclusive but merely attempt to achieve these two goals in a variety of situations. The ultimate test should always be: Is the contractor placed in a position where his judgment may be biased, or where he has an unfair competitive advantage? If so, corrective action must be taken in accordance wth the rules below."

The first three of the rules apply specifically when a contractor agrees to provide Systems Engineering and Technical Director (SE/TD) for a system, without at the same time assuming overall contractual responsibility for its development. The terms "Systems Engineering" and "Technical Direction" are defined within the rule, and are said to be terms of art relating to military procurement. The last of the four rules applies to situations where a contractor obtains data in which a competitor has proprietary rights, and the use of that proprietary data is accordingly limited.

Part 141 of 32 C.F.R. was deleted effective November 5, 1971. *See* 36 F.R. 21339 (1971). Despite this deletion, 32 C.F.R. § 113.2 continues to refer to Part 141 as containing the operative rules governing avoidance of organizational conflicts of interest. The text of former Part 141 of 32 C.F.R. remains as Appendix G of the Armed Services Procurement Regulations. At the request of this Court, counsel for all parties were invited to comment on the continued legal effect of Appendix G, following its deletion from the C.F.R. There is no doubt that both the sustaining engineering contracts awarded to Boeing, and the IRAN/Modification contract awarded to Boeing in 1971 were awarded prior to the deletion of Part 141 and hence the deletion would have no immediate effect on the subject matter of this suit. Both counsel for the plaintiff and the Government have submitted supplemental papers to this Court to the effect that the deletion of Part 141 was due to inadvertence, and that the Air Force has continued to view Appendix G as being of continued legal effect. Naturally this Court is not prepared to make findings of fact on this matter. We note that the deletion of Part 141 creates confusion as to the continued legal effect of the Rules for Avoidance of Organizational Conflicts of Interest.

taking any action pursuant to the contract awarded to Boeing; this Court on October 14, 1971, issued an order without opinion granting the Secretary of the Air Force's motion for a stay pending appeal. The plaintiff, Hayes International Corporation, then moved the district court to vacate the preliminary injunction and the matter proceeded to trial. Hayes stated that the reason it was requesting that its original preliminary injunction be vacated was that it was in the "best interest of all the parties that this case proceed as quickly as possible to a judgment on the merits" inasmuch as the challenged contract was then scheduled to extend for as long as five years.

The case was tried without a jury. The trial court found that Boeing did not enjoy an unfair competitive advantage over Hayes, nor was it guilty of a conflict of interest which might have biased its judgment and accordingly held that the contract was valid. The plaintiff brings this appeal. We affirm.

I.

Facts

The facts of this case are largely undisputed. While the expert witnesses at trial differed as to their view of the applicability of the organizational conflict of interest regulations, and to the extent of Boeing's actual advantage over other bidders seeking the contract in question, the case largely involves the legal issue of the extent to which the Armed Services Procurement Regulations apply to the facts of this case.

In March, 1971, the Secretary of the Air Force, acting through the United States Department of the Air Force, Air Force Logistics Command, Headquarters Oklahoma City Air Materiel Area, Tinker Air Force Base, issued "Requests for Proposals" for the procurement of services to perform the "inspection and repair as necessary" (IRAN), modifications and other related work on the world-

wide Air Force Fleet of KC-135 Aerial Refueling Tankers. The Requests were issued pursuant to the authority delegated to the Secretary in 10 U.S.C. § 2304(a)(10) (1970). Pursuant to the Request, on June 23, 1971, the Secretary awarded contract No. F34601-71-C-3366 to the Boeing Company, to take effect on July 2, 1971. Hayes International, the plaintiff in this suit, was one of the two unsuccessful bidders for this contract.[2]

Contract 3366 was awarded to Boeing by the Air Force in the amount of $12,294,894.16 for the first year of performance. The contract was designated to extend over a five-year period for substantially similar maintenance and repair work, based upon options available to the Government to make periodic work assignments. The five-year contract was thus valued at approximately $60,000,000.

The KC-135 is an aircraft originally manufactured by Boeing, and is used by the Air Force as a tanker for supplying fuel in mid-air to other aircraft.[3] The IRAN/Modification contract, as contracts of this sort are referred to in the industry, provided for three classes of work to be performed. The successful bidder was first to perform periodic inspections of each aircraft. The proposal submitted by each of the bidders described the procedures the bidder would follow on each aircraft and offered a per unit price for this work. Secondly the bidder agreed to perform such modifications as prescribed by the Air Force. Modifications might be performed only on individual air-

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[2] McDonnell-Douglas Aircraft Corporation was the third bidder for IRAN/Modification contract 3366.

[3] The 135 family of aircraft are the military equivalent of the Boeing 707 commercial aircraft. The KC designation describes a particular kind of 135 aircraft, and the IRAN/Modification contract in question applied only to that specific class of 135 aircraft. Other Boeing built 135 aircraft include: the C-135 cargo plane, the EC-135 electronics cargo plane, the RC-135 reconnaissance cargo plane, and the W-135 weather plane.

craft, as each suffered individual wear and fatigue following use, or as modifications might be prescribed for each aircraft in the KC-135 fleet. No estimate of total costs was possible because at the time the proposal was submitted it was not known how many aircraft would need modification, or precisely what modifications would be required. The third part of the work contracted for by the Air Force under contract 3366 was unscheduled maintenance at the time the IRAN work was being performed. Following the inspection of each aircraft there might be a variety of different types of repairs which needed to be performed. Each bid set out a formula by which payment could be estimated. This entails largely a designation of a set fee per man hour of work. Using this formula, the Air Force would be able to estimate the total costs of any particular repair on any given number of aircraft.

Hayes International had been awarded a similar contract for the forty months preceding the issuance of the Boeing contract, but lost the 1971 contract for its bid was several million dollars higher than that submitted by Boeing.

For a number of years before contract 3366 was awarded Boeing had been under contract to the Air Force to supply sustaining engineering and related support services for the KC-135 fleet. Pursuant to these contracts Boeing had made specific recommendations as to what maintenance and modifications were required on the entire fleet of more than 700 KC-135 aircraft. Boeing continues to operate under these sustaining engineering and related support services contracts. These were awarded to Boeing on a "sole source" basis without competition or open bidding,[4] as

[4] 10 U.S.C. § 2304(a) provides for the letting of contracts following formal advertising for bids. The section also sets out a number of exceptions to this requirement of formally advertising for competitive bids, including where the contract is for property or services for which "it is impracticable to obtain competition," 10 U.S.C. § 2304(a)(10).

was customary in awarding sustaining engineering contracts to the original manufacturer of a given aircraft.[5]

[5] Defendant's Exhibit No. 2 introduced and received into evidence at trial shows the 74 IRAN/Modification contracts in effect during FY '72 and the first quarter of FY '73 which had been let by one of the five Air Materiel Areas. These IRAN/Modification contracts were for maintenance on many different types of aircraft. Of the 74 IRAN/Modification programs, 51 involved aircraft for which the original manufacturer had obtained engineering support contracts which the evidence showed were similar to the sustaining engineering and related support services contracts Boeing held for the KC-135. In 16 of the 74 IRAN/Modification programs, the original manufacturer had obtained the IRAN/Modification contract. Of these 16, 11 held or had held engineering service contracts. Five manufacturers who obtained IRAN/Modification contracts had not previously held engineering support contracts. Thus 40 IRAN/Modification contracts were awarded to a contractor other than the original manufacturer, despite the manufacturer's engineering services contracts.

During FY '72 and the first quarter of FY '73 Hayes International, the plaintiff in this suit, had successfully competed against the original manufacturer holding an engineering support contract for 3 IRAN/Modification contracts—contracts for the C-130, the C-123 and the B-57 (during the first quarter of FY '73). Hayes International on five occasions during the period covered by Defendant's Exhibit 2 had competed for IRAN/Modification contracts where the original manufacturer did not hold sustaining engineering contracts.

The record shows that manufacturers routinely bid on IRAN/Modification contracts for aircraft which they had originally produced; experts in the field of Air Force procurement testified that they knew of no instance where a manufacturer had been prohibited from competing for an IRAN/Modification contract and further testified that the Air Force routinely entered into engineering support service contracts with original manufacturers similar to that which Boeing held for the KC-135. Finally the record showed that a manufacturer could obtain substantially greater profit on performing IRAN/Modification contracts than it could performing sustaining engineering services.

Defendant's Exhibit No. 2 shows that original manufacturers routinely obtain engineering support service contracts. However, the 74 IRAN/Modification programs in effect during the five

The trial court found that Boeing's relationship under the sustaining engineering and related support services contracts was essentially as the "engineering arm" of the Air Force for the KC-135 fleet.

Among its findings of fact, the trial court found: (1) as the contractor responsible for sustaining engineering for the KC-135 fleet, Boeing proposed a number of different modifications and improvements in the KC-135 design; (2) Boeing as part of its duties under the sustaining engineering contracts conducted a series of tests, evaluating fatigue stress, and other factors which affect the durability and usefulness of each aircraft; and (3) Boeing was thus privy to technical data it generated as well as that provided by the Air Force. It was undisputed that Boeing was responsible for recommending to the Air Force what priority should be placed on any particular set of repairs.

The repairs and modifications which Boeing recommended to the Air Force comprised in part the work the IRAN/Modification contractor would perform. Boeing was thus in a position to recommend changes and modifications to aircraft which would enhance the value of the IRAN/Modification contract it subsequently was awarded.

Hayes argues as a consequence of Boeing's sustaining engineering contracts it violated those D.O.D. regulations outlawing organizational conflicts of interest—both because in its dual role as both technical advisor and IRAN/Modification contractor Boeing was in a position to recommend work which it eventually performed, thereby raising the possibility of unneeded repairs being recommended to increase its own profits, and in addition because Boeing's competitive position was superior to all others bidding for the IRAN/Modification contract. This latter facet of its alleged violation of D.O.D. procurement regulations was due to Boeing's acknowledged superior opportunity to obtain and assess information—thereby enabling it to know with greater assurance what types of modifications and repairs would be performed under the IRAN/Modification contract. Because it alone knew what modifications could be expected, something which no other competitor knew with equal certainty,[6] Hayes alleges Boeing could submit a lower bid for work all bidders knew was to be performed, and recoup its profits on the additional work assignments it alone knew would be forthcoming.

quarters included in the exhibit show that such engineering support service contracts do not provide such a competitive advantage in bidding for IRAN/Modification contracts that manufacturers with sustaining engineering contracts were able to obtain a significant number of IRAN/Modification contracts. Thus the relationship between prior engineering support service contracts and subsequent bidding on IRAN/Modification contracts is uncertain.

At trial Hayes proved that Boeing recommended three specific sets of modifications which had the effect of greatly increasing the value of the IRAN/Modification contract it obtained, information which neither of its competitors possessed at the time of bidding. These three sets of repairs

[6] Hayes International, as the IRAN/Modification contractor from 1968 to 1971, was aware generally of structural problems in the aerial boom and the wing for which Boeing recommended modifications. At trial it was shown that Hayes participated in meetings at which these problems were discussed, but Hayes did not receive the same information which Boeing used in recommending modifications and repairs, and the trial court found that Boeing had access to confidential and vital information its competitors lacked.

Thus while the evidence showed that Boeing had access to information which enabled it to predict with far more certainty what modifications could be expected during the term of contract 3366, at the same time all bidders knew that many modifications could be expected. During the 40 months during which Hayes had held an IRAN/Modification contract on the KC-135, over 153 modifications were added to the contract enormously increasing its value. This was not unusual, and the record shows that the initial predicted value of a contract was almost always smaller than the ultimate value the contract was to reach after many modifications were made to it.

involved alterations to the aerial boom,[7] and two sets of wing modifications. One of the wing modifications is actually being performed by Boeing under its IRAN/Modification contract as is the aerial boom modification but the most substantial repair, Wing Fatigue Package V (which was valued as being in excess of $200,000,000) was awarded to Boeing subsequent to the filing of this litigation on a sole source basis.[8] Beyond these specific instances of advance knowledge of modifications to be performed, Hayes argues that Boeing's general responsibility for proposing modifications and repairs which were to be performed under the IRAN/Modification agreement constitutes the type of or-

[7] The aerial boom is the nozzle by which fuel is transferred in mid-air from the KC-135 tanker to other aircraft. The alterations in it which Boeing performs under its IRAN/Modification contract have an estimated cost of $2,000,000.

[8] The two sets of wing modifications were issued in the form of so-called "Wing Fatigue packages," both of which Boeing performed. Wing Fatigue Package IV was issued to Boeing under the IRAN/Modification contract 3366. Wing Fatigue Package V involved far more extensive changes in the wings of every KC-135 aircraft, and at a unit price of $313,934.00 amounts to a total cost for a modification of the entire fleet of over $200,000,000. This modification was later issued to Boeing under a separate contract, No. F34601-72-C-4213-PZ0003, as opposed to being assigned to Boeing under its IRAN/Modification contract.

Hayes at oral argument and in what it styled a "Supplemental Statement" in effect expanded its requested relief to include an injunction against the continued operation of this second contract. The Government argues, in our view correctly, that the second requested injunction constituted a new issue raised on appeal, and that under cases such as Cliff Food Stores v. Kroger, Inc., 417 F.2d 203, 208 n. 3 (5th Cir. 1969); Poston v. Caraker, 378 F.2d 439 (5th Cir. 1967); Humble Oil & Refining Co. v. Martin, 298 F.2d 163 (5th Cir. 1961), such a new issue cannot be raised at this time on appeal. It is not necessary to specifically consider the problem vigorously argued by the parties in supplemental papers whether an injunction could properly issue against this second contract, however, inasmuch as we affirm the trial court's denial of the permanent injunction requested to enjoin enforcement of contract 3366.

ganizational conflict of interest which is barred by 32 C.F.R. § 1-113.2 and Part 141 (1971).

The district court found that while Boeing had access to vital information concerning the KC-135 fleet it also found that the Air Force evaluated all recommendations made by Boeing, and that Boeing was not in a position to make final decisions on its own recommendations for modifications and repairs. The district court further found that Boeing was only one source of ideas for improvement, although it did not specify what sources other than those within the Air Force itself affected work specifications and modifications for the KC-135.

The district court found that the Air Force has made a practice of awarding sustaining engineering services contracts substantially identical to those with Boeing with the manufacturers of several other aircraft in its inventory. Some of these manufacturers have subsequently competed for IRAN/Modification contracts on the aircraft they were supplying with sustaining engineering services—at times being successful, and at times unsuccessful in bidding for the modifications which they in part proposed. The court noted that Hayes itself had competed occasionally against the holder of a sustaining engineering contract—winning some IRAN/Modification contracts, and losing others. The court found that one such example was the C-130 Lockheed built aircraft, in which competition Hayes was successful; the court noted that subsequent to the granting of contract 3366, Hayes and Boeing also competed for work on the KC-135 A aircraft, where the contract was awarded ultimately to LTV Corporation.

The district court concluded that "Service Engineering Contracts with the Air Force do not result in the contractor being in a conflicting role which might bias its judgment nor do such contracts result in the contractor obtaining an unfair competitive advantage in bidding on future contracts for work on the aircraft involved." The court

further found that the award of contract 3366 was "not contrary to public policy and the public interest in maintaining the integrity of the procurement system." The court made no specific finding as to the applicability of 32 C.F.R. § 1-113.2 and Part 141 to sustaining engineering contracts, but appears to have assumed if an actual conflict of interest was shown, or if it could be proven that Boeing enjoyed a superior competitive position due to its sustaining engineering contract, the resulting contract might be voidable.

II.

STANDING

The district court found that Hayes had standing to challenge the award of contract 3366. We agree.

The Secretary of the Air Force is required to follow procedures and practices prescribed by Congress in making procurement contracts. Foremost among these statutes is the Armed Services Procurement Act, 10 U.S.C. §§ 2301-2314 [9] and it was under the authority of this Act that the contract in question was let. Contract 3366 was awarded following "Requests for Proposals" which is a procurement procedure available to the Secretary under 10 U.S.C. § 2304(a)(10) by which he had authority to by-pass formal competitive bidding if it is impracticable to obtain competition.

Congressional limitations on discretionary awards of procurement contracts have been held to be enacted for the benefit of the public, not disappointed bidders, American Smelting & Refining Co. v. United States, 259 U.S. 75, 42 S.Ct. 420, 66 L.Ed. 833 (1922); United States v. New York

[9] *See also*, the Federal Property and Administrative Services Act, 41 U.S.C. §§ 251-260 (1970); Armed Services Procurement Regulations, 32 C.F.R. Parts 1-39 (1972); and Federal Procurement Regulations, 41 C.F.R. § 1-1.000 et seq. (1972).

& Porto Rico S. S. Co., 239 U.S. 88, 36 S.Ct. 41, 60 L.Ed. 161 (1915), and accordingly under the "legal interest" theory of standing, Tennessee Electric Power Co. v. Tennessee Valley Authority, 306 U.S. 118, 59 S.Ct. 366, 83 L.Ed. 543 (1939); Alabama Power Co. v. Ickes, 302 U.S. 464, 58 S.Ct. 300, 82 L.Ed. 374 (1938); Massachusetts v. Mellon, 262 U.S. 447, 43 S.Ct. 597, 67 L.Ed. 1078 (1923), it was thought until recently that no litigable rights are conferred on unsuccessful bidders by the statutory standards. Thus they were thought to lack standing to seek to remedy even a blatant irregularity in the procurement procedures followed by a Government agency. The leading case for this view is Perkins v. Lukens Steel Co., 310 U.S. 113, 60 S.Ct. 869, 84 L.Ed. 1108 (1940), and the Government urges us to follow it as controlling precedent.

While *Perkins* has not been expressly overruled by the Supreme Court, [10] the "legal interest" test for standing has

[10] *See, however*, Scanwell Laboratories, Inc. v. Shaffer, 137 U.S. App.D.C. 371, 424 F.2d 859 (1970) where the court notes several significant legislative enactments which arguably have the effect of legislatively overruling *Perkins*. Foremost is the passage in 1946 of the Administrative Procedure Act which provides that "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial relief thereof." The Supreme Court has held that this passage was meant to broaden the concept of standing in the area of judicial review of administrative actions, Abbott Laboratories v. Gardner, 387 U.S. 136, 140, 87 S.Ct. 1507, 18 L.Ed.2d 681 (1967).

Until *Scanwell* federal courts have, with few exceptions, followed the *Perkins* rationale that an unsuccessful bidder for a Government contract has no standing to complain. Edelman v. Federal Housing Administration, 382 F.2d 594 (2d Cir. 1967); United States v. Gray Line Water Tours of Charleston, 311 F.2d 779 (4th Cir. 1962); Friend v. Lee, 95 U.S.App.D.C. 224, 221 F.2d 96 (1965).

Scanwell has not been expressly rejected by any Courts of Appeals which have considered it, and two courts have expressly adopted its reasoning. Merriam v. Kunzig, 476 F.2d 1233 (3d Cir.

largely been abandoned. *See* Sierra Club v. Morton, 405 U.S. 727, 92 S.Ct. 1361, 31 L.Ed.2d 636 (1972); Data Processing Service v. Camp, 397 U.S. 150, 90 S.Ct. 827, 25 L.Ed. 2d 184 (1970); Barlow v. Collins, 397 U.S. 159, 90 S.Ct. 832, 25 L.Ed.2d 192 (1970); Flast v. Cohen, 392 U.S. 83, 88 S.Ct. 1942, 20 L.Ed.2d 947 (1967). While the Supreme Court has recognized that earlier cases did establish that standing would be denied "unless the right invaded is a legal right, —one of property, one arising out of contract, one protected against tortious invasion, or one founded on a statute which confers a privilege," Tennessee Electric Power Co. v. T.V.A., 306 U.S. at 137-38, 59 S.Ct. at 369, in Data Processing Service v. Camp, *supra,* the Court stated unambiguously that "the 'legal interest' test goes to the merits. The question of standing is different. It concerns, apart from the 'case' or 'controversy' test, the question whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question."

Where, as here, the plaintiff cannot rely on any specific statute authorizing judicial review of administrative decision-making, the question of standing hinges on whether the party has alleged such a "personal stake in the outcome of the controversy," Baker v. Carr, 369 U.S. 186, 204, 82

1973); William F. Wilke, Inc. v. Department of the Army, 485 F.2d 180 (4th Cir. 1973). This Court in Allen M. Campbell Co. v. Lloyd Wood Construction Co., 446 F.2d 261, 264 n. 5 (5th Cir. 1971) acknowledged that the question of standing for unsuccessful bidders was viewed as an open one, and this Court has subsequently referred approvingly to *Scanwell,* without adopting it. *See* Ray Baillie Trash Hauling, Inc. v. Kleppe, 477 F.2d 696, 704 n. 8 (5th Cir. 1973).

See generally, *Pierson,* Standing to Seek Judicial Review of Government Contracts: Its Origins, Rationale and Effect on the Procurement Process, 12 B.C.Ind. and Comm.L.Rev. 1 (1970); Comment, Government Contract Bid Protest: Judicial Review and the Role of the Court of Claims, 39 U.Chi.L.Rev. 814 (1972).

S.Ct. 691, 703, 7 L.Ed.2d 663 (1962) as to guarantee that "the dispute sought to be adjudicated will be presented in an adversary context and in a form historically viewed as capable of judicial resolution." Flast v. Cohen, 392 U.S. at 101, 88 S.Ct. at 1953. As the Supreme Court noted in Sierra Club v. Morton, "[w]here, however, Congress has authorized public officials to perform certain functions according to law, and has provided by statute for judicial review of those actions under certain circumstances, the inquiry as to standing must begin with a determination of whether the statute in question authorizes review at the behest of the plaintiff." 405 U.S. at 732, 92 S.Ct. at 1365. Recognizing that "[c]learly the momentum of recent Supreme Court decisions is in the direction of finding standing whenever 'the plaintiff alleges that the challenged action has caused him injury in fact, economic or otherwise' and that 'the interest sought to be protected by the complainant is arguably within a zone of interests to be protected or regulated by the statute or constitutional guarantee in question.'" Allen Campbell Co. General Contractors, Inc. v. Lloyd Wood Construction Co., 446 F.2d 261, 264 n. 5 (5th Cir. 1971), we believe these are the two tests the plaintiff must meet in order to establish standing to sue.[11]

[11] A third requirement is sometimes added that "there must be no 'clear and convincing' indication of a legislative intent to withhold judicial review." Ballerina Pen Co. v. Kunzig, 140 U.S.App. D.C. 98, 433 F.2d 1204, 1207 (1970); *see also* Blackhawk Heating and Plumbing Co. v. Driver, 140 U.S.App.D.C. 31, 433 F.2d 1137 (1970); Constructores Civiles De Centro America, S.A. (CONCICA) v. Hannah, 148 U.S.App.D.C. 159, 459 F.2d 1183 (1972). As the D.C. Circuit recognized in *Ballerina Pen, supra,* 433 F.2d at 1207 n. 6, this reviewability test for standing has also been treated as a separate and distinct issue, Data Processing Service, Inc. v. Camp, 397 U.S. at 156, 90 S.Ct. 827; Abbott Laboratories v. Gardner, 387 U.S. 136, 140, 87 S.Ct. 1507, 18 L.Ed.2d 681 (1967). The distinction between the two methods of dealing with the question of the scope of judicial review is murky and we choose to treat the issues separately.

A. *Injury in Fact.*

Unlike the type of delicate question which arises when a plaintiff alleges an injury of a non-economic nature to interests which are widely shared, *see, e.g.*, Sierra Club v. Morton, *supra;* United States v. Students Challenging Regulatory Procedures (S.C.R.A.P.), 412 U.S. 669, 93 S.Ct. 2405, 37 L.Ed.2d 254 (1973), the economic injury suffered by a losing bidder in seeking a government procurement contract is manifest. No serious doubt exists that Hayes International suffered economic loss by virtue of its inability to obtain the contract at issue in this case.

B. *The Zone of Interest.*

Early cases which applied the "legal interest" test of standing also made the general finding that government procurement statutes were "not intended to be a bestowal of litigable rights upon those desirous of selling to the Government . . ." Perkins v. Lukens Steel Co., 310 U.S. at 127, 60 S.Ct. at 877; American Smelting & Refining Co. v. United States, *supra;* Goldberg v. Daniels, 231 U.S. 218, 34 S.Ct. 84; 58 L.Ed. 191 (1913); Edelman v. Federal Housing Administration, 382 F.2d 594, 597 (2d Cir. 1967); United States v. Gray Line Water Tours of Charleston, 311 F.2d 779 (4th Cir. 1962). These authorities do not, however, directly answer the question whether the interests of a disappointed bidder fall within the zone of interests arguably protected by a statute or regulation, for even if the plaintiff is unable to assert a violation of a legal right which the court may remedy, "once review is properly invoked, that person may argue the public interest in support of his claim that the agency has failed to comply with its statutory mandate." Sierra Club v. Morton, 405 U.S. at 737, 92 S.Ct. at 1367. It was indeed largely on this premise that a disappointed bidder is uniquely suited to assert a public interest in the Government's compliance with relevant statutes regulating procurement that led the D.C. Circuit to hold a losing bidder has standing to contest an arguably illegal Government contract—despite the fact it may not necessarily be able to assert a "legal right" to the contract. Scanwell Laboratories, Inc. v. Shaffer, 137 U.S.App.D.C. 371, 424 F.2d 859 (1970).

Here we believe the interests of competitors are at least arguably within the zone of interests protected by the Department of Defense regulations or organizational conflicts of interest. Those regulations, under which this suit was brought, 32 C.F.R. § 1-113.2 and Part 141 (1971), set out rules which are intended to achieve two different but related goals: avoiding those conflicts of interest which bias a contractor's judgment, and avoiding situations where one contractor has an unfair competitive advantage over another. It seems probable that this latter goal is at least in part designed to protect the interests of competitors who are unable to obtain government contracts due to the superior competitive position of the successful bidder, whose competitive advantage is the result of its prior confidential relationship with the Government.

References to the goal of avoiding unfair competitive advantages for a contractor in a privileged position with the Government frequently occur in the legislative reports and hearings preceding drafting of the organizational conflicts of interest procurement regulation. *See, e.g.*, Organization and Management of Missile Programs, H.R.Rep. No. 112, 86th Cong., 1st Sess., 88, 92, 95 (1959); House Comm. on Gov't Operations Avoiding Conflicts of Interests in Defense Contracting and Employment, H.R.Rep. No. 917, 88th Cong., 1st Sess., 4, 52 (1963). While these references draw no formal distinction between the Government's interest in free competition, and the interest of a competitor—these cited passages do express a broad concern that unfair competition may result, and the regulation subsequently drafted seems sufficiently broad to incorporate both the Government's interest in lower prices and higher quality through

free competition, as well as the industry's interest in maximizing the opportunity for each competitor to bid on an equal footing.

C. *Effect on Future Procurement.*

While the Government urges this Court to dismiss the suit on authority of Perkins v. Lukens Steel, *supra,* and thus affirm the requirement that a formal legal interest must be found before a party has standing to challenge the grant of a Government contract, the Government also proposed larger grounds for refusing to review procurement decisions of the sort involved in this case.[12] These concerns are both serious and important, and we do not feel we can ignore them. While we ultimately deny the relief the plaintiff requests, we do not do so on the basis that Hayes lacks standing to raise the issues presented, and we recognize we may thus occasion other challenges to Government procurement which necessarily will have effects on the manner in which the Government conducts military procurement.

In its seminal opinion of Scanwell Laboratories, Inc. v. Shaffer, *supra*, the D.C. Circuit Court took note that there

[12] The Supreme Court in *Perkins* expressly referred to the possible effects on the procurement process as contributing to its holding that an unsuccessful bidder lacked standing to sue.

> "Courts should not, where Congress has not done so, subject purchasing agencies . . . to the delays necessarily incident to judicial scrutiny at the instance of potential sellers . . . . A like restraint applied to purchasing by private business would be widely condemned as an intolerable business handicap. It is, as both Congress and the courts have always recognized, essential to the even and expeditious functioning of Government that the administration of the purchasing machinery be unhampered." 310 U.S. at 130, 60 S.Ct. at 878.

See also, Lind v. Staats, 289 F.Supp. 182, 186 (N.D.Cal. 1968) for a strong statement of the possible harm resulting from interference with essential Government procurement. *See also* discussion M. Steinthal and Co. v. Seamans, 147 U.S.App.D.C. 221, 455 F.2d 1289, 1300 (1971).

were justifiable concerns that judicial review of procurement decisions may have a disastrous effect on the efficient operation of Government procurement. In matters such as the one before us in this case, where the procurement decision touches on weapons systems which may have a vital impact on national defense, the courts must be wary of intruding into areas where they have neither special competence nor the ability to act expeditiously.[13] Despite these concerns, we feel we must follow the line of authority which began with *Scanwell.*

There is now a substantial body of case law in the D.C. Circuit which by now almost routinely applies *Scanwell* and grants judicial review of procurement decisions. *See e.g.,* P.A.M. News Corp. v. Hardin, 142 U.S.App.D.C. 227, 440 F.2d 255 (1971); National Automatic Laundry and Cleaning Council v. Shultz, 143 U.S.App.D.C. 274, 443 F.2d 689 (1971); Blackhawk Heating and Plumbing Co. v. Driver, 140 U.S.App. D.C. 31, 433 F.2d 1137 (1970); Ballerina Pen Co. v. Kunzig, 140 U.S.App.D.C. 98, 433 F.2d 1204 (1970), cert denied 401 U.S. 950, 91 S.Ct. 1186, 28 L.Ed.2d 234

[13] Our decision in Allen M. Campbell Co. v. Lloyd Wood Construction Co., 446 F.2d 261 (5th Cir. 1971) demonstrates the type of inefficiency which may be occasioned by judicial review of procurement decisions. In that case the district court originally entered an injunction restraining the Air Force from entering into a contract for the construction of housing when the plaintiff contended that the bidder to whom the contract was to be awarded was ineligible because it was not a "small business" within the meaning of the relevant statute. 318 F.Supp. 1167 (N.D.Ala. 1970). The Air Force because it determined that the housing was urgently needed, complied with the injunction and awarded the contract to the plaintiff. On appeal, this Court determined that the Air Force's original determination was reasonable, and that the injunction had been erroneously granted. Subsequently, the Court of Claims ordered the Government to pay damages to the original successful bidder flowing from the Air Force's obedience to the district court's order. 467 F.2d 931, 199 Ct.Cl. 515 (1972). As a consequence of this litigation, the Government was in effect required to pay two different bidders for the same work.

(1971); M. Steinthal and Co. v. Seamans, 147 U.S.App.D.C. 221, 455 F.2d 1289 (1971); Wheelabrator Corp. v. Chafee, 147 U.S.App.D.C. 238, 455 F.2d 1306 (1971); Kentron Hawaii, Ltd. v. Warner 156 U.S.App.D.C. 274, 480 F.2d 1166 (1973). As that Court observed in *M. Steinthal and Co., supra,* the administration of suits involving military procurement has not been without its problems—frivolous suits are occasionally filed, and not infrequently the delay occasioned by judicial review has a harmful effect on the smooth and efficient operation of military procurement. Procurement decisions are frequently complex and involve factual issues courts are ill-equipped to settle. Obviously many procurement decisions involve delicate questions of policy which are better left to the expertise of an executive agency to answer.

At least in part the problem has been to develop proper standards in determining when a discretionary injunction should issue. Many different factors are necessarily taken into account in making a decision of this sort, and the experience in the D.C. Circuit has shown that the grant of an injunction which has the effect of delaying possibly vital procurement may have grave effects on the national interest. Among the various factors which have been expressly recognized as proper to take into account in determining whether an injunction should issue are: (1) the importance to national defense of the item to be procured;[14] (2) the availability of alternative remedies, either in the Court of Claims[15] or a bid protest claim to the General Accounting

[14] Ray Baillie Trash Hauling, Inc. v. Kleppe, 477 F.2d 696 (5th Cir. 1973,.

[15] *M. Steinthal and Co., supra,* 455 F.2d at 1302. The damages available in the Court of Claims are normally limited to those costs associated with preparation of the losing bid. *See* Keco Industries, Inc. v. United States, 428 F.2d 1233, 192 Ct.Cl. 773 (1970); Robert F. Simmons and Associates v. United States, 360 F.2d 962, 175 Ct. Cl. 510 (1966); Heyer Products Co. v. United States, 140 F.Supp. 409, 135 Ct.Cl. 63 (1956) and 177 F.Supp. 251, 147 Ct.Cl. 256 (1959).

Office;[16] and (3) the substantial likelihood that statutory standards were in fact violated.[17] Further the plaintiff has been held to bear a heavy burden of proving that a procurement officer's decision was genuinely arbitrary and unreasonable.[18] We agree that there is a "strong public interest in avoiding disruptions in procurement, and for withholding judicial interjection unless it clearly appears that the case calls for an assertion of an overriding public interest [at] 'in having the agencies follow the regulations which control government contracting.'" *M. Steinthal and Co., supra,* 455 F.2d at 1300. At the same time, we do not believe that denying review altogether is the proper way to temper judicial discretion in granting injunctions which may have harmful effects on military and Government procurement.

[16] Wheelabrator Corp. v. Chafee, 147 U.S.App.D.C. 238, 455 F.2d 1306, 1313 (1971). *See* 4 C.F.R. Part 20 for the bid protest procedures issued by the Comptroller General, and *see generally,* Cibinic and Lasken, The Comptroller General and Government Contracts, 38 Geo.Was.L.Rev. 349 (1970).

[17] As the D.C. Circuit specifically noted in *M. Steinthal and Co., supra,* 455 F.2d at 1301, the federal courts must pay particular respect to what might be fairly called the "common law of government procurement"—the body of rulings determinations emanating from executive officials and the uniquely situated appeals determinations of the Comptroller General and quasi-judicial boards such as the boards of contract appeals in many of the various procurement agencies. Thus the deference normally owed an agency's interpretation of its own authorizing statutes and regulations may in some cases induce a federal court in its sound equity discretion to withhold issuance of the preliminary injunction if the agency can demonstrate the likelihood that its procurement decisions followed accepted agency practice.

[18] Kentron Hawaii, Ltd. v. Warner, 156 U.S.App.D.C. 274, 480 F.2d 1166 (1973); *M. Steinthal and Co., supra,* 455 F.2d at 1301; Continental Business Enterprises, Inc. v. United States, 452 F.2d 1016, 196 Ct.Cl. 627 (1971); *Keco Industries, Inc., supra,* 428 F.2d at 1240.

III.

REVIEWABILITY

The Administrative Procedure Act, 5 U.S.C. § 701(a) provides that the provisions of the Act authorizing judicial review apply "except to the extent that—(1) statutes preclude judicial review; or (2) agency action is committed to agency discretion by law." The Supreme Court has held that there is virtually a presumption in favor of judicial review, Abbott Laboratories v. Gardner, 387 U.S. 136, 140, 87 S.Ct. 1507, 18 L.Ed.2d 681 (1967) unless a contrary purpose is fairly discernible in the statutory scheme. Data Processing Service v. Camp, 397 U.S. 150, 157, 90 S.Ct. 827, 25 L.Ed.2d 184 (1970). Agency action is normally found to be non-reviewable "only upon a showing of 'clear and convincing evidence' of a contrary legislative intent." Abbott Laboratories v. Gardner, 387 U.S. at 141, 87 S.Ct. at 1511.

32 C.F.R. § 1-113.2 and Part 141 do not expressly preclude judicial review, but neither do they mandate it. Clearly the absence of statutory language expressly authorizing judicial review is insufficient to offset the presumption that administrative action is reviewable. "Indeed, judicial review of such administrative action is the rule, and nonreviewability an exception which must be demonstrated." Barlow v. Collins, 397 U.S. 159, 166, 90 S.Ct. 832, 838, 25 L.Ed.2d 192 (1970). However, "[a] clear command of the statute will preclude review; and such a command of the statute may be inferred from its purpose." *Id.* at 167, 90 S.Ct. at 838.

The Government points to those provisions of the regulations which provide that "[a]ny of the prohibitions imposed by these rules may be waived by an Assistant Secretary of a military department or the Director of a defense agency if he determines that a failure to waive the prohibition will be prejudicial to the best interests of the Government," 32 C.F.R. Part 141 (1971) as well as the repeated statement that "[a]ll prospective contractors will

be advised of the applicability of the rules by a notice in solicitations and by a clause in resulting contracts," *Id.*, and "[t]he contracting officer shall not impose restrictions under the Appendix in follow-on procurements on any prospective contractor in the absence of a specific contractual agreement with that contractor," 32 C.F.R. § 1-113.2(c) and argue that taken together they amount to such a "clear command" that the regulations are meant to be applied only at the discretion of the agency.

That part of Appendix G which provides for "Review and Waiver" seems to us to grant substantial discretion to procurement officers. Indeed, Hayes concedes that the Air Force could have made the decision to waive the application of the Rules on Avoidance of Organizational Conflicts of Interests. Implicitly the plaintiff also concedes that were such a decision made, it likely would be unreviewable as it would be one of those "rare instances where 'statutes are drawn in such broad terms that in a given case there is no law to apply.'" Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 410, 91 S.Ct. 814, 821, 28 L.Ed.2d 136 (1971). We do not pass on that question, however, as such a waiver decision was not made in this case. Rather, the Air Force has determined that the Rules on Avoidance of Organizational Conflicts of Interest are never applicable to the type of engineering contracts which Boeing held prior to the grant of IRAN/Modification contract 3366. In our view, this construction of the regulations is a decision other than a specific decision to waive the application of the rules in a particular instance, having made the decision that a failure to do so would be "prejudicial to the best interests of the Government."

Such a construction of the regulations "does not significantly engage the agency's expertise," Barlow v. Collins, 397 U.S. at 166, 90 S.Ct. at 837, for "Courts are as expert as administrators in matters of statutory construction." East Oakland-Fruitvale Planning Council v. Rumsfeld, 471

F.2d 524, 529 (9th Cir. 1972). *See* Barlow v. Collins, 397 U.S. at 166, 90 S.Ct. 832.[19]

Thus the issue in this case comes down to the relatively straightforward one of the extent to which the Department of Defense rules on avoidance of organizational conflicts of interest were meant to apply to the type of engineering contracts which Boeing held for the KC-135. The decision that Boeing's sustaining engineering and related support services contracts did not come within the purview of the rules was not made on the basis of the "best interests of the Government," rather the record shows it was made on the basis of a construction of the language of the regulations, and the legislative history surrounding the drafting of the rules. Such matters are eminently fit for judicial review, and while naturally an agency's interpretation of its own regulations is subject to substantial deference,[20] this does not amount to unreviewable discretion within the meaning of § 701(a) of the Administrative Procedure Act.[21]

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[19] An analogous question would be the extent to which an agency has discretion to construe its own authorizing legislation to determine the extent to which its decisions are to be unreviewable. In such cases, normally the initial inquiry as to the construction of an agency's authorizing legislation is held to be a matter proper for judicial review, even if ultimately the decision is that the agency has unreviewable discretion under that legislation. *See* East Oakland-Fruitvale Planning Council v. Rumsfeld, *supra;* Fletcher v. Housing Authority of Louisville, 491 F.2d 793 (6th Cir. 1974). Similarly, " '[w]here the only or principal dispute relates to the meaning of the statutory term' . . . [the controversy] presents issues on which courts, and not [administrators], are relatively more expert." Barlow v. Collins, 397 U.S. at 90 166 S.Ct. at 837, *citing* Hardin v. Kentucky Utilities Co., 390 U.S. 1, 14, 88 S.Ct. 651, 19 L.Ed.2d 787 (Harlan, J., dissenting).

[20] *See generally,* 4 K. C. Davis, Administrative Law Treatise, § 30.12 (1958).

[21] The Government and Boeing argue that by the terms of 32 C.F.R. § 1-113.2 and Part 141, the failure of the government to include provisions in Boeing's sustaining engineering contracts barring future bidding on IRAN/Modification contracts should

IV.

APPLICABILITY OF THE DEPARTMENT OF DEFENSE RULES ON AVOIDANCE OF ORGANIZATIONAL CONFLICTS OF INTERESTS TO ENGINEERING SUPPORT CONTRACTS

As the Government has had to rely increasingly on the use of private contractors to perform tasks which might previously have been performed by Government employees, the problem of reconciling the private interests of independent contractors with the public mission they are called upon to perform has resulted in substantial legislative concern about conflicts of interest. The problem has been particularly acute concerning use of individual Government employees who have some interest in private concerns, and both the legislation and the literature concerning this question of so-called "individual conflicts of interest" have been extensive.[22] Such "individual conflicts of interest"

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preclude retroactive application of the Rules on Organizational Conflicts of Interest. We note without passing on the question that other procurement regulations have been held to be self-enforcing despite the failure to include them in specific contracts, *see, e.g.,* G. L. Christian and Associates v. United States, 312 F.2d 418, 160 Ct.Cl. 1 (1963). Further the Comptroller General has recently decided that the failure to include such a ban in a prior contract need not bar an application of restrictions similar to those of 32 C.F.R. Part 141, if such a restriction is made consistent with 10 U.S.C. § 2304(g) which requires solicitation of proposals "from the maximum number of qualified sources consistent with the nature and requirements of the supplies or services to be procured." Decision of the Comptroller General, B-181448 of October 15, 1974. *See OGC Newsletter,* Office of the General Counsel, Dept. of the Navy, Vol. 21, No. 4 (12/16/74).

[22] *See* 18 U.S.C. §§ 201-219 (1964). *See generally,* Manning, Federal Conflict of Interest Law (1964); Perkins, The New Federal Conflict of Interests Law, 76 Harv.L.Rev. 1113 (1963); Petrowitz, Conflict of Interests in Federal Procurement, 29 Law and Contemp. Prob. 196 (1964); Pasley, Individual Conflicts of Interest (Briefing Paper No. 64-4, Federal Publications, Inc.) (1964).

have been defined as "the clash, or appearance of a clash, between a Government official's interest in performing his official duties and his interests in his private—and especially his private economic—affairs." Association of the Bar of the City of New York, Conflict of Interests in Federal Service, 3 (1960). Here the statutory restrictions are relatively clear, and well understood. The same cannot be said of "organizational conflicts of interest" which have been described by one of the leading scholars in the field as a "more mysterious, arcane subject, on which much less has been published and about which very little that is definitive can yet be said." Pasley, Organizational Conflicts of Interests in Government Contracts, 1967 Wis.L. Rev. 5, 6.

"Organizational conflicts of interest," unlike ones concerning individual employees, normally do not arise in most aspects of public service. Rather they have been described as "essentially creatures of federal government contract law and policy, more specifically of research and development contracting and of complex space age technology." Pasley, *Id.*

32 C.F.R. § 1-113.2 and Part 141 were drafted to deal with what a series of Congressional hearings and reports identified as the continuing problem of organizational conflicts of interest in aerospace procurement.[23] At trial the

[23] *See* for his account of the development of the D.O.D. regulations, Pasley, Organizational Conflicts of Interest in Government Contracts, 1967 Wis.L.Rev. 5, 6 *et seq.* *See also* House Committee on Government Operations, Organization and Management of Missile Programs, H.R.Rep.No.1121, 86th Cong., 1st Sess. (1959); House Committee on Government Operations, Air Force Ballistic Management (Formation of Aerospace Corporation), H.R.Rep.No. 324, 87th Cong., 1st Sess. (1961); U.S. Bureau of the Budget, Report to the President on Government Contracting for Research and Development, S.Doc.No.94, 87th Cong., 2nd Sess. (1962); House Committee on Government Operations, Avoiding Conflicts of Interest in Defense Contracting and Employment, H.R.Rep.No.917, 88th Cong., 1st Sess. (1963); Hearings Before the Sub-Committee of the House Committee on Government Operations, Organization and Management of Missile Programs, 86th Cong., 2nd Sess. (1960); Hearings Before a Sub-Committee of the House Committee on Government Operations, Systems Development and Management, 85th Cong., 1st Sess. (1963).

Government introduced witnesses who either participated in the drafting of the regulations in question, or who subsequently were responsible for applying them in military procurement contracts, who testified that the rules were intended to apply to situations where a highly specialized contractor engaged in what was called "systems engineering" and "technical direction."[24] "Systems engineering" is defined by 32 C.F.R. Part 141 to include "a combination of substantially all the following activities: determination of specifications, identification and solution of interfaces between parts of the system, development of test requirements or plans and evaluation of test data, and supervision of design work." The term "technical direction" is similarly defined to include "a combination of substantially all the following activities: preparation of work statements for contractors, determination of paramaters, direction of contractors' operations, and resolution of technical controversies." While some of these technical terms seem so conceptually broad as to include some, although certainly not all, of Boeing's responsibilities under its sustaining engineering contracts, Government witnesses at trial testified that the type of post-production engineering which Boeing was expected to perform under

[24] Among the other equally ambiguous generic terms used to describe similar functions are: "systems analysis and engineering and technical monitoring and direction," Staff of Sub-Committee for Special Investigations of the House Committee on Armed Services, 89th Cong., 1st Sess., The Aero Space Corporation 7 (Comm.Print. 1965) or, more generally, "Planning, technical, analytical, or other consulting services." Proposed Atomic Energy Commission, "Statement of General Policy for the Avoidance of Organizational Conflicts of Interest," 31 F.R. 2699, 2700 (1966).

its sustaining engineering contracts was qualitatively different from the kind of engineering effort described by the terms "systems engineering" and "technical direction." Typically this latter type of engineering was said to involve development of new systems, and the coordination of the contributions of a number of sub-contractors in an effort to speed research, development and production.

The Government relies not only upon what individuals who participated in the drafting of the regulations suggested was the intent behind the language used within the regulation, but also refers to the specific instances of systems engineering and technical direction which had been identified by Congressional committees investigating organizational conflicts of interest as creating a problem which required a solution.[25]

Expert Government witnesses testified that there were fundamental differences between the type of engineering responsibilities involved in developing a new weapon system, and that which are involved in performing maintenance engineering on an existing system. These witnesses

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[25] The prototype of such a contractor was the Ramo-Wooldridge Corporation, later known as the Thompson-Ramo-Wooldridge Corporation, later responsible for the separate incorporation of Space Technology Laboratories, a wholly-owned subsidiary of Thompson-Ramo. The history of these corporations, and their role in developing the ballistic missile system for the Air Force are extensively reported in two House of Representative's reports, H.R.Rep.No. 1121, and H.R.Rep.No.324, *supra,* note 23. Ramo-Wooldridge was responsible for the coordination of sub-contracting in the development of the ballistic missile system—and as such had enormous influence in making decisions about what equipment and services should be acquired by the Government. It seems plain to us that if what Ramo-Wooldridge was performing in the late '50s is what the terms "systems engineering" and "technical direction" were meant to describe, then Boeing's sustaining engineering contracts bear no meaningful relationship to the type of engineering responsibilities vested by the Air Force in the Ramo-Wooldridge Corporation.

testified that contracts led by the Logistics Command simply were not "system engineering" or "technical direction" contracts within the meaning of the regulations. Sustaining engineering was identified as resembling "fix-it" engineering although the precise conceptual differences between such "fix-it" engineering and the "very sophisticated type of technical management" which was said to be involved in systems engineering and technical direction were left largely unarticulated.

The plaintiff produced no evidence as to the intent of the draftsman of 32 C.F.R. § 1-113.2 and Part 141, nor any evidence as to how the terms "system engineering" and "technical direction" are viewed by specialists in military procurement. Rather Hayes simply says that to read the language of the regulation is enough, that the words are so clear no extrinsic evidence is required. However, it only requires a single attempt to read and understand the cabalistic jargon of the regulations to conclude that the words cannot stand alone.

We do not feel that the plaintiff has offset the weight we attach to the administrative interpretation of the regulations and to the intent attributed to the draftsman of the regulation by participants in the drafting process. One such participant in the drafting process, then a special assistant to the Secretary of Defense, has described the problems the regulations were designed to solve. Yarmolinsky, Organizational Conflicts of Interest, 24 Fed.B.J. 309 (1964). He describes the development of "systems engineering and technical direction" as responding to a need which arose "because weapons systems had become so complex that the job of fitting together separate systems, sub-systems, and sub-sub-systems, turned out to be at least as important as the job of producing component elements. Contractors were needed to perform what came to be called systems engineering and technical direction, which amounted to giving the contractor a very large say in what the ultimate customer—the Government— was going to buy."

We are thus unable to read 32 C.F.R. §1-113.2 and Part 141 so broadly as to encompass all engineering tasks assigned by contract by the military. Such a reading is inconsistent with the background to the drafting of the regulation, and has never been the interpretation placed upon it by the agencies responsible for military procurement. In our view, the limited reading placed on the regulations by the various procurement agencies is consistent with the legislative materials which prompted the drafting of the regulation originally, and with the attempted solution of the specific problem those legislative hearings and reports documented.

We thus conclude that the Air Force's administrative interpretation of 32 C.F.R. §1-113.2 and Part 141 is a permissible interpretation, and we do not disturb it.[26]

Accordingly, we affirm the judgment of the trial court.

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[26] The plaintiff proposes an alternative basis on which it seeks to have contract 3366 voided. Relying on what it identifies as the rationale of *United States* v. *Mississippi Valley Generating Co.*, 364 U.S. 520, 81 S.Ct. 294, 5 L.Ed.2d 268 (1961), the plaintiff proposes that a general public policy against conflicts of interests is sufficiently strong to justify voiding a contract which arguably is tainted by such a conflict of interest. We feel we must decline the invitation to develop such a novel "federal common-law of Government procurement," premised upon what a court can be persuaded is desirable procurement policy.

No authority is cited for this dramatic use of federal equity power save the *Mississippi Valley Generating* case, and it is admittedly distinguishable on the grounds that it involved the violation of a penal conflict of interest statute, and thus did not require a decison to void a Government contract premised solely on the court's intuitive sense of what is desirable public policy. The penal statute in question, 18 U.S.C. § 434 was said to be given its "fair meaning in accord with the evident intent of Congress," 364 U.S. at 550, 81 S.Ct. at 309, and the Supreme Court by its own terms did nothing more than construe that intent. We find nothing in the case which authorizes so broad a use of discretionary power as to justify creating new and novel limitations on military procurement.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ALABAMA, SOUTHERN DIVISION

CIVIL ACTION No. 71-831-A

HAYES INTERNATIONAL CORPORATION, *Plaintiff*

v.

DR. ROBERT C. SEAMANS, JR., Secretary of the Air Force, *Defendant*

THE BOEING COMPANY, a Corporation, *Intervenor*

Order of Dismissal

In conformity with the Findings of Fact and Conclusions of Law entered contemporaneously herewith,

It is ORDERED, ADJUDGED and DECREED by the Court that plaintiff is not entitled to the relief for which it prays; that this action be and the same is hereby dismissed; and that the costs of court incurred herein be and the same are hereby taxed against plaintiff.

DONE this 30th day of April, 1973.

/s/ SEYMOUR H. LYNNE
Senior Judge

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ALABAMA, SOUTHERN DIVISION

CIVIL ACTION No. 71-831-S

HAYES INTERNATIONAL CORPORATION, *Plaintiff*

v.

DR. ROBERT C. SEAMANS, JR., Secretary of the Air Force, *Defendant*

THE BOEING COMPANY, a Corporation, *Intervenor*

This cause, coming on to be heard, was submitted upon the alternative prayers of plaintiff for a permanent injunction or a declaratory judgment upon the pleadings and the proof. After full consideration thereof, aided by the memoranda and oral arguments of able counsel, the Court proceeds to make and enter the following findings of fact and conclusions of law:

FINDINGS OF FACT

(1) On or about March 29, 1971, defendant, acting through the United States Department of the Air Force, Air Force Logistics Command, Headquarters Oklahoma City Air Materiel Area, Tinker Air Force Base, Oklahoma, 73145, issued Request for Proposals (RFP) No. F34601-71-R-1488 for the procurement of certain services to perform the "inspection and repair as necessary" (IRAN), modifications (otherwise known as Technical Order compliance) and other related services on the worldwide Air Force fleet of KC-135 aerial refueling tankers. The RFP was issued pursuant to the authority delegated to the defendant in 10 U.S.C. § 2304(a)(10) (1970), and requested proposals to be submitted by offerors on or before 4:30 p.m., Central Standard Time, May 17, 1971. The date for receipt of proposals was later extended to June 4, 1971.

(2) Pursuant to the Request for Proposals, on June 23, 1971, defendant awarded Contract No. F34601-71-C-3366 to The Boeing Company (hereinafter "Boeing"), effective July 2, 1971, in the amount of $12,294,894.16 for the first year of performance. The provisions of the RFP and of the resulting contract anticipated delivery by the Air Force of KC-135 aircraft to Boeing for IRAN/Modification work beginning on or about October 12, 1971.

(3) At the time of the solicitation of the Request for Proposals, plaintiff, Hayes International Corporation, was performing similar IRAN/Modification services for the Air Force on the KC-135 fleet under Contract No. F34601-68-C-3607, and had been doing so since March, 1968.

(4) Such contract contemplated a five-year period of substantially similar work requirements based upon annual options available to the Government.

(5) Plaintiff initiated an inquiry to the Air Force because of the inconsistency between the face amount of the contract and a newspaper report of the potential value of the contract to Boeing. The purpose of the inquiry was to ascertain the nature and extent of other contracts prevailing between Boeing and the Air Force which also concerned the KC-135 fleet. On the basis of a review of such other contracts supplied to plaintiff by the Air Force pursuant to the Freedom of Information Act, plaintiff concluded that:

(a) Boeing held a privileged relationship with the Air Force as the only contractor providing engineering services and recommendations on maintenance requirements and modifications which should be performed on KC-135 aircraft;

(b) that privileged relationship was of such a nature that Boeing alone, among the offerors for Contract No. F34601-71-C-3366, had superior knowledge and information concerning pending modifications to the

KC-135 fleet that would result in work requirement changes and additions to IRAN/Modification Contract No. F34601-71-C-3366; and, therefore,

(c) the competition for Contract No. F34601-71-C-3366 was unfair and Boeing had an *unfair competitive advantage* over all other offerors;

(d) a *conflict of interest* existed between Boeing's performance of sustaining engineering services for the Air Force on the KC-135 fleet and the performance of IRAN/Modification services under Contract No. F34601-71-C-3366; and

(e) Boeing's judgments and engineering decisions made under its KC-135 service contracts with the Air Force would be *biased* in favor of maintenance requirements and modifications which Boeing would perform and receive the economic benefit of as the IRAN/Modification contractor under Contract No. F34601-71-C-3366.

(6) On July 15, 1971, plaintiff submitted various questions to the Air Force concerning the bidding and award of Contract No. F34601-71-C-3366, and particularly concerning the unfair competitive advantage which Boeing enjoyed in the alleged "Competition" for the contract. Additionally, plaintiff pursued its administrative remedies, to the extent they existed, by consulting with and bringing the questions of unfair competition, conflict of interest, and bias to the personal attention of, among others, the then Assistant Secretary of the Air Force, Philip N. Whittaker. All such inquiries were to no avail.

(7) At all times pertinent to this litigation, specifically prior to, at the time of, and after the award of Contract No. F34601-71-C-3366 to Boeing for IRAN/Modification services on the KC-135 fleet, Boeing and the Air Force were parties to a series of contracts whereunder Boeing furnished the Air Force sustaining engineering and related support services on the worldwide Air Force KC-135 fleet. Pursuant to these contracts, Boeing advised and recommended to the Air Force what specific maintenance and modification requirements were to be performed on the entire Air Force fleet of more than 700 KC-135 aircraft. Boeing continues to operate under such contracts and to provide these services for the Air Force on the KC-135 fleet at this time. The contracts include Nos. F34601-71-C-0799; F34601-72-C-1782; F34601-72-C-2039; F34601-71-D-2291; and F34601-71-A-1408, all as amended, modified, superseded, or replaced by substantially similar contracts.

(8) All of the KC-135 sustaining engineering and related support services contracts referenced in the prior numbered finding were awarded to Boeing by the Air Force on a "sole source" basis without competition or open bidding.

(9) During the early part of the 1950's, Boeing developed a prototype jet transport aircraft, which was privately financed, and subsequently developed a tanker aircraft for use by the Air Force from this prototype. The Air Force has procured 732 of these aircraft from Boeing, having an inventory value of $1,692,134,780.00. This aircraft, known as the KC-135A, has the mission of providing worldwide aerial refueling support for all "First Line" bombers, fighters, tactical and special mission aircraft (reconnaissance and weather configuration).

(10) Pursuant to the KC-135 sustaining engineering and related support services contracts, Boeing functions as the engineering arm of the Air Force for the KC-135 fleet. Because of the information provided to Boeing by the Air Force to perform under such contracts, Boeing had access to vital information concerning the KC-135 fleet.

(11) As with all its aircraft, the Air Force has the responsibility of assuring that the KC-135A aircraft are

properly maintained and ready to fulfill critical National Defense mission requirements. This maintenance work may be done in Air Force facilities or it may be contracted out to private contractors. During the first ten years of operation, modification and maintenance work on the KC-135A aircraft was performed primarily in Air Force facilities. By December of 1967, other Air Force work had led the Air Force to conclude that the modification and maintenance work on the KC-135A aircraft should be contracted out. In January, 1968, proposals were received from five contractors including plaintiff and Boeing.

(12) The 1968 procurement of maintenance and modification work on the KC-135A aircraft, known as IRAN/Modification work was contracted to plaintiff, Hayes International Corporation, since it was determined to be the lowest, responsive proposer on the 1968 procurement. This contract was extended through exercise of options through the first 90 days of fiscal year 1972, and was numbered F34601-68-C-3607.

(13) Following essentially the same procedures as in 1968, the Air Force again requested proposals for a new modification and maintenance work contract on the KC-135A aircraft by Request for Proposal issued March 29, 1971. In response to this RFP, three bids were submitted, proposals from Hayes International Corporation, The Boeing Company, and McDonnell-Douglas Company. As a result of this competition, The Boeing Company was awarded the IRAN/Modification Contract F34601-71-C-3366 because it was the lowest, responsive, responsible proposer. The Boeing Company's proposal was several million dollars lower than was plaintiff's. McDonnell-Douglas, who was the other bidder on this procurement, submitted a manpower estimate which was approximately one million (1,000,000) man-hours less than the Hayes estimate and was more comparable to the man-hours estimate presented by Boeing.

(14) The modification work called for by the contract at issue here originates when changes or improvements are recommended. The manufacturer of the KC-135A aircraft, a highly sophisticated technological system, is one source of ideas for improvement. Once a change or improvement is proposed, the Air Force screens the proposals before it actually makes the decision to incorporate any change. These procedures include all improvement ideas furnished to the Air Force's Engineer Services Division. If considered sound, they are subsequently transmitted to the systems manager of the KC-135A aircraft system. This individual is responsible for determining that further required review procedures are followed prior to any recommended change being accepted for use on the KC-135A aircraft. Configuration Control Boards may give additional technical and engineering evaluation as to the basic improvement. If these boards, composed of technicians and engineers experienced and authoritative in the military aircraft field, conclude that the specific improvement should be incorporated into the aircraft, the systems manager is then responsible for directing the idea to its final stage, to see that it is incorporated into the aircraft, and that all technical manuals are accordingly modified or updated. The final decision regarding the making of any modification is made by the Air Force.

(15) After a modification is approved by the Air Force, a Technical Order (TO) is prepared which involves setting out the technical terms so that installation service can be performed. The function of a Technical Order is to finally relate every step as simply as possible so that qualified personnel can understand how to do the job at the field level.

(16) Technical Orders are also prepared so that personnel will have detailed instructions for performance of maintenance work (IRAN). If, in the course of tearing down or disassembling an aircraft or system or equipment therein and inspecting it, it is determined that re-

pairs are necessary, such repairs are made. The inspections and repairs are made in compliance with the IRAN work statement in the IRAN/Modification contract, which work statement is prepared solely by the Government. Technical Orders for maintenance of the KC-135A aircraft were basically established at the time of acquisition of the aircraft. The manufacturer of the aircraft, Boeing, does assist necessarily in preparation of changed Technical Orders for performance of maintenance work but, as with other Technical Orders, each Technical Order is analyzed by the Air Force at the time it is implemented. The changes in Technical Orders at this time are few and inconsequential compared to the entire body of basic TO's related to IRAN.

(17) At the time offers were solicited on the first contract for modification and maintenance work on the KC-135A aircraft in 1968, none of the potential contractors complained or alleged that Boeing was precluded from bidding on the contract due to bias or unfair competitive advantage. Likewise, the contracting officer was never presented with any questions of biased judgment or unfair competitive advantage relating to Boeing's eligibility in the competition for contract F34601-71-C-3366 either before award or immediately subsequent thereto. If plaintiff had ever lodged any formal complaint and set forth its reasons for excluding Boeing as a competitor, the Contracting Officer would have been required, under his review authority, to render a final decision and submit same through channels to the Assistant Secretary of the Air Force (I&L) for decision. No such action was ever initiated or requested by Hayes. No protest was made to the Comptroller General of the United States.

(18) The Air Force has engineering services contracts substantially identical to those with Boeing for the KC-135A (F34601-71-C-0799, F34601-71-A-1408, F34601-67-C-0419, etc.) with the manufacturers of several other aircraft in its inventory. Certain of these same manufacturers have competed for IRAN/Modification contracts on the aircraft involved and have been successful in some competitions and unsuccessful in others. Hayes has competed for some of these same contracts and has been successful in certain competitions against these aircraft manufacturers who have engineering services contracts on the aircraft involved. One instance of such success was with relation to the C-130 Lockheed-built aircraft, which competition took place after that for contract F34601-71-C-3366. Hayes also competed for work on the KC-135A aircraft after award of F34601-71-C-3366, which competition was won by LTV Corporation.

(19) Service engineering contracts with the Air Force do not result in the contractor being in a conflicting role which might bias its judgment nor do such contracts result in the contractor attaining an unfair competitive advantage in bidding on future contracts for work on the aircraft involved.

(20) In bidding upon and being awarded Contract No. F34601-71-C-3366, Boeing

(a) was not involved in conflicting roles which might bias a contractor's judgment; and

(b) did not have an unfair competitive advantage.

(21) The bid of the Boeing Company under the subject RFP was not materially unbalanced as to price and does not reflect superior knowledge and inside information available to Boeing by virtue of its engineering services contracts with the Air Force for the KC-135 which was unavailable to other offerors.

(22) The award of Contract F34601-71-C-3366 was not contrary to public policy and the public interest in maintaining the integrity of the procurement system.

CONCLUSIONS OF LAW

(1) This Court has jurisdiction of the subject matter of this action for declaratory judgment and injunctive relief and the parties pursuant to 28 U.S.C. §§ 1331, 1361, 2201 and 2202 (1964); and Section 10 of the Administrative Procedure Act [5 U.S.C. § 702 (1970)]. There is now existing between the parties an actual and justifiable controversy.

(2) The award of Contract No. F34601-71-C-3366 to Boeing has not resulted in an inherent and illegal conflict of interest with respect to Boeing by virtue of its contracts (F34601-71-C-0799 and related contracts) with the Air Force for sustaining engineering and other related service work on the KC-135A aircraft. Such award was not arbitrary and capricious, and not contrary to public policy and the public interest in maintaining the integrity of the procurement system, and not contrary to the applicable law.

(3) The plaintiff (Hayes International Corp.) has failed to establish the award of Contract No. F34601-71-C-3366 by the Department of the Air Force to the Boeing Company was improper because of the existence of any unfair competitive advantage.

(4) The application for permanent injunction or, in the alternative, for a declaratory judgment, should be denied.

An order of dismissal will be entered in accordance with the foregoing findings and conclusions.

DONE this 30th day of April, 1973.

/s/ SEYMOUR H. LYNNE
Senior Judge

APPENDIX C

Armed Services Procurement Regulation

1—113.2 *Organizational Conflicts of Interest.*

(a) Appendix G—Rules for the Avoidance of Organizational Conflicts of Interest sets out some of the more essential policy considerations of the Department of Defense with respect to relationships with non-Federal institutions. Specifically, Appendix G describes examples of various organizational conflicts of interest which might come into being, and rules for avoidance of such conflicts; and it provides that action must be taken to avoid placing a contractor in a position where his judgment might be biased or where he would have an unfair competitive advantage within the scope and intent of the rules. However, the Appendix cannot of itself impose any obligations on the contractor; such obligations must be imposed by a contract clause designed to carry out the intent of the Appendix. Furthermore, potential contractors must be advised in the solicitation as to the extent of applicability of the rules, and must be given an opportunity to negotiate on the terms of the clause and its application.

(b)(1) The contracting officer is responsible for applying the rules in the Appendix to contracts under his cognizance and shall determine whether each proposed procurement is subject to the Appendix.

(2) If the contracting officer initially determines with respect to a particular procurement that a potential conflict of interest exists, he shall, before issuing the solicitation, prepare a written analysis, including a statement as to which of the four rules (or other conflict of interest not stated in the rules) he considers applicable, and a recommended solicitation notice and clause designed to avoid the organizational conflict of interest. A standard form of solicitation notice or clause is not prescribed in this Regulation since such notices and clauses must be especially

adapted to apply the principle of the rules to the specific facts of each contractual situation. The clause shall spell out the specific extent of any future restrictions on the contractor. The restrictions of the proposed clause shall also have a specific time period of effectiveness. As a general rule, the time effectiveness of any clause which excludes the contractor from participation in subsequent procurement shall have a fixed term of reasonable duration as appropriate, except that where Rule 1 of Appendix G is involved the exclusion shall be permanent. A fixed term of reasonable duration is measured by the time required to avoid the circumstance of unfair competitive advantage. This is variable; for example, it may run to the date of award of the first production contract or for a stated period of time. (See Rules 2 and 3 of Appendix G.) In no event shall an exclusion be stated in the clause without a specific date, or an event certain, terminating the effectiveness of the exclusion except where Rule 1 is involved.

(3) The contracting officer shall include the determination, together with the written analysis, in the negotiation file or record. The approved solicitation notice and proposed clause shall then be included in the solicitation, together with a clear statement that the proposed clause and the application of the Appendix are subject to negotiation.

(4) In no case shall the clause included in a solicitation or in a contract (including letter contracts) pursuant to this paragraph 1—113.2 defer the determination of the application of the Appendix to a time after the contract has been awarded.

(5) Where a contract contemplates a Rule 4 situation, it is incumbent on the contracting officer to assure himself that the agreement called for by Rule 4 is in fact executed, and that copies thereof are made available to the Government.

(c) The contracting officer shall not impose restrictions under the Appendix in follow-on procurements on any prospective contractor in the absence of a specific contractual agreement with that contractor. If, during the effective period of any restriction, procurement responsibility for the system or item involved is transferred from the procuring activity which imposed the restriction that activity shall notify the transferee of the restriction and send it a copy of the contract under which it was imposed.

(d) The Departments shall maintain, in accordance with Departmental procedures, and for an appropriate period of time as determined by the circumstances, a record of all solicitation notices and all clauses incorporated in contracts pursuant to this paragraph 1—113.2.

APPENDIX G

Avoidance of Organizational Conflicts of Interest

I. Preamble

The Report to the President on Government Contracting for Research and Development (generally known as the Bell Report) states that "today about 80% of Federal expenditures for research and development are made through non-Federal institutions" and that "there is no doubt that the Government must continue to rely on the private sector for the major share of the scientific and technical work which it requires."

In such contracting, it is the policy of the Department of Defense that the contractor should be given the maximum responsibility and authority for the performance of assigned tasks, and these tasks be of such a nature, even when they are part of a major system, as to be self-contained from a management point of view. The Report further states that there are certain essential management functions in the research and development area that must be retained within Government. For instance, the integration and coordination of the separate parts of a large weapons system contract involving several major contractors would, as a general rule, be handled by Government agencies. To achieve this integration and coordination, however, special arrangements are sometimes needed such as are made with nonprofit organizations and industrial organizations. In this case, the Government must be able to establish rules for its relationships with the nonprofit or industrial organizations which may be stricter than those normally employed with prime contractors. All prospective contractors will be advised of the applicability of the rules by a notice in solicitations and by a clause in resulting contracts.

Where the Department of Defense does contract for research and development work, as it must for the bulk of

that work, its choice of a contractor should be based primarily upon two considerations:

"(1) Getting the job done effectively and efficiently, with due regard to the long-term strength of the Nation's scientific and technical resources, and

"(2) Avoiding assignments of work which would create inherent conflicts of interest."

The Report points out that while there are advantages and disadvantages to the various types of organizations within the private sector (universities, private nonprofit organizations and industrial corporations), these types of organizations should not "be given areas of monopoly on different kinds of work," or be permitted to develop a privileged relationship to the Department of Defense.

In connection with the second criterion, the Report proposes that each department develop a "Code of Conduct" for organizations in the research and development field. These rules have been developed in accordance with that instruction.

It should be borne in mind that the pragmatic test for the selection of a contractor for a particular research and development contract covers both profit and nonprofit organizations, including those created largely or wholly with Government funds. But the rules do not deal with the criteria for the creation of additional Government-sponsored nonprofit organizations in this category. It is the policy of the Department of Defense that such organizations are created only under extraordinary circumstances, when private resources are not available to accomplish a necessary objective beyond the scope of in-house capabilities. Their termination is governed by the organic statutes of the individual organizations. These rules should make it even less likely that any additional Government-financed nonprofit organizations need be created.

While these organizations are in existence they will be treated by the Department on arms length basis, as the rules prescribe.

II. Rules

The following rules state general prohibitions which are then explained and illustrated by specific examples. There will undoubtedly occur cases which are not resolved by these rules. As the Bell Report said, "[Conflict of Interest] arises in several forms—not all of which are by any means yet fully understood." In order to assist in deciding what, if any, prohibitions should be applied in such instances, the two basic principles of this code—(1) preventing conflicting roles which might bias a contractor's judgment, and (2) preventing unfair competitive advantage—should be paramount. The following rules and examples are not all inclusive but merely attempt to achieve these two goals in a variety of situations. The ultimate test should always be: Is the contractor placed in a position where his judgment may be biased, or where he has an unfair competitive advantage? If so, corrective action must be taken in accordance with the rules below.

As used in these rules, "contractor" means the person under contract to the Department of Defense to perform the work described in each rule, and its affiliates; "system" means system, subsystem, project or item. The term "systems engineering" includes a combination of substantially all the following activities: determination of specifications, identification and solutions of interfaces between parts of the system, development of test requirements or plans and evaluation of test data, and supervision of design work. The term "technical direction" includes a combination of substantially all the following activities: preparation of work statements for contractors, determination of parameters, direction of contractors' operations, and resolution of technical controversies.

1. If a contractor agrees to provide systems engineering and technical direction (SE/TD) for a system, without at the same time assuming over-all contractual responsibility for: (a) development, or (b) integration, assembly and checkout (IAC), or (c) production of the system, then that contractor shall not later be allowed to supply the system or any major components thereof, or to be a subcontractor or consultant to a supplier of the system or any major components thereof.

Explanation: The SE/TD contractor occupies a highly influential and responsible position as an agent of the Department of Defense both in determining basic concepts of a system and in supervising their execution by other contractors. To assure the objectivity of its services and hence a more soundly planned system, the SE/TD contractor must not be in a position to make decisions which could favor its own products. Furthermore, it would be inconsistent with the managerial responsibility of an SE/TD contractor for it to be concurrently one of the component suppliers.

Example A: Company A agrees to provide SE/TD for the Navy on the power plant for a group of submarines (i.e., turbine, drive shafts, props, etc.). Company A shall not be allowed to supply any power plant components. Company A can, however, supply components of the submarine unrelated to the power plant (e.g., fire control, navigation, etc.). In this example, the system is the power plant, not the submarine, and the ban on the supply of components is coterminous with the system only.

Example B: Company A is the SE/TD contractor for system X. After some progress, but prior to completion, the system is cancelled. Later, system Y is developed to achieve the same purposes as system X, but in a fundamentally different fashion. Company B is the SE/TD contractor for system Y. Company A may bid to produce system Y or its components.

2. If a contractor agrees to prepare and furnish complete specifications covering nondevelopmental items to be used in competitive procurement, that contractor shall not be allowed to furnish such items, either as a prime or subcontractor, for a reasonable period of time including, at least, the initial procurement. This rule shall not apply to:

a. Contractors who furnish at Government request specifications or data with respect to the product they furnished, even though the specifications or data may have been paid for separately or in the price of the product.

b. Situations where one or more contractors acting as industry representatives assist Department of Defense agencies in preparing, refining or coordinating specifications, regardless of source, which assistance is supervised and controlled by Government representatives.

c. Contracts for developmental or prototype items.

Explanation: If a single contractor is engaged by the Government to draft complete specifications for nondevelopmental equipment, he should be eliminated for a reasonable time from competition for production based on the specifications. This should be done in order to avoid a situation where he could draft specifications which would favor his own products or capabilities. In this way the Government can be assured of getting unbiased advice as to the content of its specifications and can avoid allegations of favoritism in the award of production contracts.

In development work it is normal to select firms which have done the most advanced work in the field. It is to be expected that these firms will design and develop around their own prior knowledge. Development contractors can frequently start production earlier and more knowledgeably than firms which did not participate in the development, and this affects the time and quality of production, both of which are important to the Department of Defense. In many instances the Government may have financed such

development. Thus, the development contractor may have an unavoidable advantage which is not considered unfair and no prohibition should be imposed.

In instances of cooperation between industry and Department of Defense agencies to prepare, refine or coordinate specifications, there is continuous participation and supervision by Government representatives and, usually, more than one contractor concerned. In these circumstances Government supervision prevents the establishment of specifications oriented to favor a given contractor's products or capabilities.

Example A: Company A prepares updated Government specifications for a standard refrigerator to be procured competitively. Company A shall not be allowed for a reasonable period of time to compete for supply of the refrigerator.

Example B: Company A designs or develops a new electronic equipment and, as a result of the design or development, prepares specifications. Company A may supply the electronics equipment.

Example C: XYZ Tool Company and/or KLM Machinery Company representing the American Tool Institute work under the supervision and control of Government representatives to refine specifications or to clarify the requirements of a specific procurement. These companies may supply the item.

3. If a single contractor, other than a company which has participated in the development or design of a system, agrees to assist the Department of Defense or a contractor of the Department of Defense in the preparation of a statement of work, or agrees to provide material leading directly, predictably, and without delay to a statement of work, to be used in the competitive procurement of a system or services, that contractor shall not be allowed to supply the services, or the system or major components thereof,

unless he is the sole source. The content of a statement of work shall not be considered predictable if more than one contractor is involved in the preparation of material leading to it.

Explanation: The various services related to a statement of work to be used in a competitive procurement should normally be performed by the Department of Defense. However, when it is necessary to seek the assistance of contractors, they may often be in a position to favor their own products or capabilities. To overcome this possibility of bias, such contractors are to be prohibited from supplying a system or services procured on the basis of work statements growing out of their services.

No prohibitions are imposed on development contractors for the reasons given in the explanation to Rule 2.

Example A: Company A receives a contract to define the detailed performance characteristics the Department of Defense will require for the purchase of rocket fuels. A has not developed the particular fuels. At the time the contract is awarded, it is clear to both parties that the performance characteristics arrived at will be used by the Department of Defense to choose competitively a contractor to develop or produce the fuels. Company A shall not be permitted to bid on this procurement.

Example B: Company A receives a contract to prepare a detailed plan for the procurement of services aimed at the advanced scientific and engineering training of Department of Defense personnel. It suggests a curriculum which the Department of Defense endorses and incorporates in requests for proposals to various institutions to establish and conduct such training. Company A shall not be permitted to bid on this procurement.

Example C: Company A prepares a feasibility study of a new weapons system without proposing in detail the

characteristics of a possible final device. It may bid to produce the system or components thereof.

4. If a contractor agrees to conduct studies or provide advice concerning a system, which work requires access to proprietary data of other companies, the contractor must agree with such companies to protect such data from unauthorized use or disclosure so long as it remains proprietary. In addition, the contractor shall not be permitted to utilize the data in supplying the system, or components thereof, procured, either by formal advertising or negotiation, as a direct result of that study or advice, or in performing for the Department of Defense additional studies in the same field which are obtained competitively.

Explanation: Proprietary data is information considered so valuable by its owners that it is held secret by them and their licensees. Where a contractor must obtain such data from others for purposes of the study, and can obtain it by the leverage of the Department of Defense contract, he will gain an advantage over other companies unless there are restrictions upon his use of the data. Such restrictions are necessary both to protect the data, and to encourage companies to furnish it to contractors for the necessary performance of the Department of Defense contract. The rule is not intended to protect proprietary data furnished voluntarily by companies without limitations as to use, or data which falls into the public domain.

Example A: Company A is selected to study the use of lasers in military communications. The Department of Defense will request that firms doing research in the field make proprietary data available to A. In order to receive the contract, A must agree with such firms to protect any proprietary data it obtains, so long as it remains proprietary, and shall not be permitted to utilize the data in supplying any lasers to the Department of Defense. Furthermore, while A could not receive a competitively awarded contract to perform additional studies of lasers

using such data, it may receive a sole source contract for such studies.

Review and Waiver

The contracting officer is responsible for applying these rules to contracts under his cognizance. If the prospective contractor disagrees with his decision, the contracting officer shall report his decision, and the contentions of the contractor, through channels to an Assistant Secretary of a Military Department or the Director of a Defense Agency for decision.

Any of the prohibitions imposed by these rules may be waived by an Assistant Secretary of a Military Department or the Director of a Defense Agency if he determines that a failure to waive the prohibition will be prejudicial to the best interests of the Government.